TOTAL

Total Petroleum (North America) Ltd.

1977 Annual Report

COMPANY PROFILE

Total Petroleum (North America) Ltd. is a growing petroleum company active in exploration and production in Canada and the United States, and refining and marketing in the mid-continent U.S.

TOTAL commenced operations in the mid-1950's developing oil and gas production in western Canada. Through the merger with Leonard Refineries, Inc. of Alma, Michigan in 1970, operations were expanded into the U.S. to include refining and marketing as well as exploration and production in Michigan. U.S. oil and gas production and reserves increased significantly in 1976 with the acquisition of Hanover Petroleum Corporation.

The acquisition of Apco Oil Corporation's Arkansas City, Kansas refinery and associated pipelines and terminals in 1978 will more than double TOTAL's refining capacity in the U.S. while the purchase of Apco's Canadian oil and gas producing properties in late 1977 increased the Company's Canadian production and reserves by about 10%. TOTAL plans to continue expanding its operations in North America through capital expenditures and acquisitions.

Highlights

TOTAL®

OPERATING	1977	1976
Crude oil production (barrels per day) (i)	9,744	9,711
Natural gas sales (thousands of cubic feet per day) (i)	44,370	43,130
Proven crude oil reserves (barrels)	36,790,000	38,503,000
Proven gas reserves (thousands of cubic feet)	250,249,000	244,400,000
Crude oil refined (barrels per day)	41,074	38,520
Refined product sales (barrels per day)	48,997	47,754

FINANCIAL
(U.S. Dollars)

	1977	1976
Total revenue	$349,469,000	$298,718,000
Net earnings	14,964,000	10,446,000
Earnings per share	1.17	.82
Funds provided by operations (ii)	41,657,000	32,433,000
Capital expenditures (iii)	40,298,000	34,521,000
Shareholders' equity	131,017,000	117,144,000
Total assets	351,190,000	264,871,000

(i) Includes Hanover Petroleum Corporation's average daily production for full year in 1977 and for eight months in 1976.

(ii) Net income plus income charges not affecting working capital in the year. Refer to Consolidated Statement of Changes in Financial Position for other sources and uses of funds.

(iii) Excludes acquisition of Hanover Petroleum Corporation in 1976 and certain assets from Apco Oil Corporation in 1977.

CONTENTS

To Our Shareholders:

For Total Petroleum (North America) Ltd., the year 1977 was highlighted by the continuation of a vigorous trend of growing earnings and cash flow, and by a new major acquisition.

TOTAL's 1977 results are summarized on the accompanying graphs and on the previous page. The most significant yardstick of our performance, funds provided by operations, increased to $41,657,000, up 28% from $32,433,000 in 1976. Net income increased to $14,964,000, or $1.17 per share, up from $10,446,000, or $0.82 per share, in 1976.

In view of the steady improvement of our earnings over the past several years, and because of our confidence in maintaining a positive trend, we initiated a cash dividend on our common shares at the end of 1977.

During 1977, one year after the acquisition of Hanover Petroleum Corporation for $47 million in 1976, TOTAL took another major step toward significant expansion of its assets. On August 19, 1977, TOTAL agreed to purchase a portion of the assets of Apco Oil Corporation for $65 million subject to certain adjustments, plus inventories and receivables at the closing. This transaction is part of a plan of liquidation of Apco. The purchased assets include Apco's Arkansas City, Kansas refinery and its associated pipelines and terminals, and also Apco's Canadian oil and gas producing properties. The Canadian producing properties were acquired on December 20, 1977, and have increased our Canadian reserves and production by about 10%. The purchase of the U.S. refinery, pipelines and terminals suffered considerable delay caused by administrative procedures of the Department of Energy and could not be completed by the end of 1977. This acquisition will more than double TOTAL's refining capacity, expand our market into ten additional mid-continent states, and enhance the flexibility and efficiency of our overall crude oil supply and product distribution systems. The effects of this major acquisition will be seen in 1978 and increasingly in future years.

Apart from the Apco acquisition, TOTAL continued an aggressive capital expenditure program in 1977, amounting to $40.3 million versus $34.5 million in 1976. Approximately two-thirds of the 1977 total was spent for exploration and development of oil and gas. Greater relative emphasis was placed on refining and marketing than in previous years, reflecting the nearly completed upgrading program of the Alma refinery.

In 1978, capital outlays for our expanded operation are expected to again exceed levels of the previous year, and follow a similar pattern of distribution among various activities.

* * * *

The increase in TOTAL's 1977 cash flow, that facilitated our record capital expenditures, resulted from improvements in each of our three major operating areas:

- Canadian oil and gas production
- U.S. oil and gas production
- U.S. refining and marketing

These three profit centers contributed approximately equal shares to our total 1977 operating cash flow.

The analysis of the 1977 cash flow, compared to 1976, is detailed in the "Management Discussion and Analysis" section of this report. The operational and economic factors affecting cash flow in 1977 and future years are described in the "Exploration and Production" and "Refining and Marketing" sections respectively. The factors discussed below are of particular significance.

In Canada, current increases in cash flow primarily reflect the successive price increases granted by the government. Because of oil proration and temporary lack of market for additional gas, production volumes do not reflect TOTAL's full potential, nor the additions to this potential resulting from 1977 gas discoveries.

For the longer term, an aggressive land acquisition program in Alberta and British Columbia has consolidated our previously strong land positions in areas which have recently shown great promise, such as the Elmworth area of northwestern Alberta. We plan to increase our exploration expenditures in these areas and are confident that these actions will result in increased gas reserves and production, and increased cash flow within the next few years. It is reasonable to expect that discovery of substantial new reserves by the industry, and construction of the proposed Alaska-Canada natural gas pipeline will stimulate the development of new markets, particularly additional exports to the U.S.

In the U.S., the increase of cash flow from production primarily reflects the acquisition of Hanover Petroleum on April 30, 1976 and, to a lesser extent, the continued upward trend of our Michigan production. The maintenance of our U.S. production and income requires a high level of drilling activity, financed by our own resources, and further leveraged by public drilling programs which Hanover Petroleum continues to sell and manage. The cost of finding and developing a barrel of oil, or a thousand cubic feet of gas, in the continental U.S. has increased significantly in recent years. The relationship of finding costs to current and projected wellhead prices requires close attention, in order to secure a satisfactory return on our exploration investment.

Cash flow from refining and marketing operations increased substantially in 1977, reflecting the initial effects of the Alma refinery upgrading program, improvement in our crude supply pattern, and continued streamlining of our marketing channels. The 1977 cash flow also reflects exceptionally good margins during the first half year, in the wake of the severe 1976-1977 winter. Margins gradually diminished toward the end of the year as temporary product surpluses developed. This serves as a reminder that refining and marketing margins and cash flow will always remain subject to short-term upward or downward fluctuations, reflecting short-term supply-demand relationship and, in recent years, distortions caused by government regulations.

During 1977, TOTAL made substantial commitments to the future in refining and marketing operations. These include:

• the nearly-completed $13 million upgrading program of the Alma refinery

• and of even greater impact, the agreement to acquire Apco's 46,000 BPD refinery located at Arkansas City, Kansas and its associated pipelines and terminals.

These commitments were based on our belief that there is good long-term profit potential for refining and marketing in the United States. The demand for petroleum products, including gasoline, will continue at current or somewhat higher levels for many years to come, even with ambitious conservation goals. Nationwide, refining capacity is below demand, unlike Canada, Western Europe and Japan. Construction of new refineries in the U.S. is severely inhibited by environmental regulations and inflation. Existing refineries with modern facilities, connected to efficient crude supply and product distribution systems, serving appropriate marketing channels, and properly managed, are bound to be competitive and profitable in the long run. We believe this to be the case for both the Alma and the Arkansas City refineries in their respective regional markets. Confidence in the ability of our operating management, and of Apco's operating management to be hired by TOTAL, was also a major factor in our decisions.

* * * *

For TOTAL to carry out its current and future plans, adequate financial resources are required. We rely primarily on internally generated funds to finance capital expenditures associated with current operations. Thus, an important corporate objective is to continue to increase funds provided by operations. In addition, the acquisition of assets that add to our existing strength is another permanent objective. We believe that such acquisitions can and should be financed by debt. This was the case with Hanover Petroleum and will be the case with the Apco assets.

Financial flexibility and a strong balance sheet are required to sustain a two-pronged policy of growth through vigorous capital expenditures and continued acquisitions. It was to enhance this flexibility, with a view to future developments, that we recently announced a proposed common share offering. TOTAL's major financial goal remains to increase the real net worth of the Company which, together with the recently initiated dividend policy, should provide its shareholders with an attractive total return on their investment.

* * * *

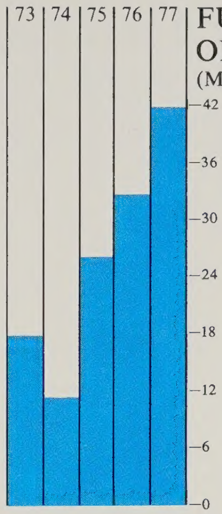
All our actions and decisions are taken against a background of government policies and regulations which are often unpredictable, and sometimes inconsistent, thereby adding another dimension of risk and uncertainty. At the present time, this is particularly true in the United States where the President and the Congress have not yet formulated new energy legislation, after one year of debate.

In contrast, Canadian government policies have been more consistent and realistic over the past two years. The announced policy of gradually increasing oil and gas prices to world levels has contributed to renewed confidence and aggressiveness on the part of exploration companies in Canada, including TOTAL.

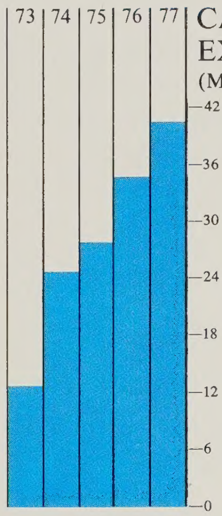
The energy scene in North America continues to be dominated by the challenge towards greater self-sufficiency. In spite of growing, and often counter-productive government interference, the challenge will have to be met by private industry in an environment which remains very open and competitive by today's world standards. TOTAL is a relatively small company in North America. Our recent history has shown that opportunities exist, for a company our size, to successfully play its part. We will continue to look for such opportunities, recognize them, and use all of our talents and abilities to develop them for the benefit of our shareholders.

On behalf of the Board of Directors,

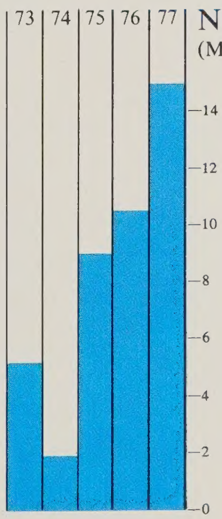
Philippe Dunoyer, President



FUNDS PROVIDED BY OPERATIONS
(Millions of U.S. Dollars)



CAPITAL EXPENDITURES
(Millions of U.S. Dollars)



NET INCOME
(Millions of U.S. Dollars)

Management Discussion and Analysis

The discussion which follows includes a brief description of significant factors affecting the Company's operating results. The Summary of Operations appearing on pages 18 and 19 of this report provides operating and financial information for the last five years and should be read in conjunction with this discussion.

The Company has two operating divisions–Exploration and Production operates in Canada and the United States, and Refining and Marketing operates in the United States. The Summary of Operations presents funds provided by operations and a summary of earnings with details for amounts directly attributable to the divisions. Certain administrative expenses and certain amounts included in the other income account are incurred at the corporate level and, accordingly, are not allocated to the divisions. Interest and income tax expenses are also not allocated.

Exploration and Production

Funds provided by operations of the Exploration and Production division increased in each of the years presented in the Summary. Increasing prices and, in the two most recent years, the acquisition of Hanover Petroleum Corporation have been the primary contributing factors to this trend.

On April 30, 1976 the Company acquired Hanover Petroleum Corporation. More than half of the increase in funds provided by the Exploration and Production division in both 1976 and 1977 resulted from the inclusion of Hanover's activities in those years.

In early 1977, the Canadian federal government announced its intention to allow the wellhead price of crude oil to increase $1.00 per barrel on each July 1st and January 1st until January 1, 1979. The July 1, 1977 and January 1, 1978 increases have been implemented. Natural gas prices have increased proportionally. These increases result from the government's energy strategy of gradual adjustment of crude oil prices to world levels, and an adjustment of gas prices to their energy equivalent. Though oil and gas producers have received only a portion of the benefits from the price increases due to increased royalties and taxes payable to the federal and provincial governments, the increases have generated significant additional funds.

As a result of regulations of the United States federal government, the Company's average sales price for crude oil in 1977 was approximately the same as the prior year. Prices for a substantial portion of the production were decreased in early 1977, but allowed to

return to former levels later in the year. Increases in the sales prices of natural gas in 1977 accounted for most of the increase in sales revenue due to sales prices. A majority of the Company's U.S. natural gas production is exempt from federal price controls but subject to sales contracts. Prices have increased as allowed by escalation provisions in the agreements and as contracts expire.

Excluding the effect of Hanover, sales quantities have had much less impact on the increases in funds provided from operations than have sales prices. Canadian production volumes have suffered from curtailments required by provincial proration programs in recent years. During 1976, and to a lesser extent 1977, the Company's Michigan production increased substantially but the increases represent a small percentage of the total production volumes.

The following table is an analysis of the increases in funds provided by the Exploration and Production operations in the two most recent years (in thousands of U. S. dollars):

	Canada	U.S. (Excluding Hanover)	Hanover	Total
Funds provided by operations in 1975	$ 9,492	$ 2,903	$ –	$12,395
Increase (decrease) in 1976 due to:				
Increased sales revenues (net of royalties) due to:				
Sales quantities	(340)	2,343	10,375	12,378
Sales prices	3,171	1,313	–	4,484
Other income	–	–	251	251
	2,831	3,656	10,626	17,113
Increased operating and administrative expenses	(446)	(823)	(3,503)	(4,772)
Total increase	2,385	2,833	7,123	12,341
Funds provided by operations in 1976	11,877	5,736	7,123	24,736
Increase (decrease) in 1977 due to:				
Increased sales revenues (net of royalties) due to:				
Sales quantities	329	1,102	3,900	5,331
Sales prices	2,221	484	1,736	4,441
Other income	–	–	133	133
	2,550	1,586	5,769	9,905
Increased operating and administrative expenses	(381)	(649)	(1,581)	(2,611)
Total increase	2,169	937	4,188	7,294
Funds provided by operations in 1977	$14,046	$ 6,673	$11,311	$32,030

Depreciation and depletion attributable to the Exploration and Production division increased by $5,053,000 and $3,772,000 in 1976 and 1977, respectively. This expense increases as production quantities and capital costs increase. Depletion expense also is affected by the higher cost to find and develop mineral reserves. The acquisition of Hanover and the resulting increase in facilities, production volumes and depletion rate per barrel caused a substantial portion of the large increase in 1976 and a lesser increase in 1977. Depletion expense for 1977 was recorded at $2.28 per equivalent barrel of production. The 1976 rate was $2.06. This rate is computed by dividing proven reserves into the accumulated undepleted cost of exploration, development and reserve acquisitions. Natural gas reserves are included in the calculations by converting cubic feet to oil barrel equivalents based on their relative sales values.

Refining and Marketing

Funds provided by Refining and Marketing operations have varied widely over the years, principally because of changing margins. During the last five years prices for crude oil and other materials for the entire industry have moved progressively upward. The market conditions for refined products, however, fluctuated during the period, to a large degree because of extensive government regulation.

During 1975, 1976 and 1977 gasoline margins, based on the average manufactured cost for all refined products, have been reasonably stable. This has not been true for other refined products. The decrease in funds provided from Refining and Marketing operations in 1976 was substantially caused by the depressed market prices for asphalt and residual fuel during 1976 relative to 1975.

The increase in funds generated from operations in 1977 resulted from four basic operating improvements. First, during 1977 the refinery operations began to reflect the results expected from the $13 million refinery improvement program. The refinery yield of gasoline was increased over 1976, while the yields of asphalt and residual fuel were decreased. Second, heating fuel margins, which improved during the winter of 1976-1977, remained high throughout 1977. Third, the margin realized on products which the Company purchases and resells was greater in 1977 than in 1976. Fourth, continued operating improvements in the company-operated service station network resulted in an increase in funds provided from this source in 1977.

The following table provides details of the increase or decrease in funds provided by the Refining and Marketing division for 1976 and 1977 (in thousands of U.S. dollars):

Funds provided by operations in 1975	$16,756
Increase (decrease) in 1976 due to:	
Increased revenues—	
Increased sales through company-operated service stations due to:	
Sales quantities	12,945
Sales prices	4,172
Other sales increases due to:	
Sales quantities	4,519
Sales prices	9,733
Other income	1,592
	32,961
Increased cost of purchased crude oil, products and merchandise due to—	
Purchase quantities	(15,218)
Purchase prices	(18,450)
	(33,668)
Increased operating, marketing and administrative expenses—	
Direct expenses at company-operated service stations	(2,097)
Other	(1,320)
	(3,417)
Total decrease	(4,124)
Funds provided by operations in 1976	12,632
Increase (decrease) in 1977 due to:	
Increased revenues—	
Increased sales through company-operated service stations due to:	
Sales quantities	10,573
Sales prices	6,919
Other sales increases (decreases) due to:	
Sales quantities	(1,356)
Sales prices	25,527
Other income	(707)
	40,956
Increased cost of purchased crude oil, products and merchandise due to—	
Purchase quantities	(3,492)
Purchase prices	(25,736)
	(29,228)
Increased operating, marketing and administrative expenses—	
Direct expenses at company-operated service stations	(929)
Other	(5,818)
	(6,747)
Total increase	4,981
Funds provided by operations in 1977	$17,613

The changes in revenues and expenses for company-operated service stations are segregated in the above table due to the growing importance of these operations over the two-year period and because of the resulting impact on operating expenses. The majority of these increases are related to the program to convert Detroit service stations to high volume, gasoline-only outlets.

Operating, marketing and administrative expenses, other than those associated with company-operated service stations, increased by 4% in 1976 and 17% in 1977. Increases in refinery energy cost accounted for approximately one-half of the 1977 and essentially all of the 1976 increase primarily because of operating certain of the refinery units at greater severity to obtain higher yields of gasolines.

General

Interest income from short-term investments increased in 1976. The 1976 increase in interest expense, and to a lesser extent 1977, reflects the approximately $47 million of new debt incurred in connection with the acquisition of Hanover. Interest expense also increased as borrowings were completed in 1977 in anticipation of the acquisition of certain assets from Apco Oil Corporation. The pending acquisition also caused increases in unallocated administrative expense.

Income tax expense tends to vary directly with net income before deduction for income tax expense. The Canadian effective tax rate decreased in 1977 after a similar decrease in 1976 from the 1975 rate. Investment tax credits in the United States increased in 1977 over 1976.

Market and Dividend Information

The principal markets for each class of the Company's securities entitled to vote at the Annual Meeting are the Toronto Stock Exchange in Canada and the American Stock Exchange in the United States. A dividend of 17½¢ (U.S.) per share was paid on the Preferred Series A shares for each quarterly period within the two most recent fiscal years. A quarterly dividend of 5¢ (Can.) per share on Common shares was declared in 1977 for payment in 1978. The high and low sales prices of the Common and Preferred Series A shares of the Company during each quarterly period were as follows:

		Quarter			
Toronto Stock Exchange (Can. $)		1	2	3	4
Common (TPN)					
1976	High	6⅜	8	8	7⅞
	Low	5	6⅛	6⅛	5
1977	High	8⅜	9⅝	10⅞	13
	Low	6¼	6⅝	8⅛	8¼
Preferred Series A (TPN.PR.A)					
1976	High	14⅛	16	16	15⅞
	Low	11¼	12⅜	12½	11½
1977	High	17	20½	22¼	25¾
	Low	14½	14¾	17½	18¼
American Stock Exchange (U.S. $)					
Common (TPN)					
1976	High	6⅝	8¼	8¼	7¾
	Low	4⅞	6⅛	6⅜	5⅛
1977	High	8⅜	9¼	10¼	11⅞
	Low	5⅞	6¼	7⅝	7⅜
Preferred Series A (TPN.PR.A)					
1976	High	13⅝	16½	16⅝	15¾
	Low	10⅞	12½	13	11⅞
1977	High	17	19½	21¼	23⅝
	Low	13⅞	13⅞	16	16¾

Exploration and Production

1977 was a very active and successful year for TOTAL's exploration and production operations. Cash flow from production was a record $32 million, up 30% from 1976. The 1977 drilling program was the largest ever undertaken. Capital expenditures for exploration and development were $27 million and, when added to the $5.4 million of public drilling programs raised by Hanover Petroleum, the Company's exploratory and development exposure was well in excess of $30 million. TOTAL participated in the drilling of 237 wells (119 exploratory and 118 development wells). This activity resulted in the discovery of 72 oil wells and 44 gas wells. Average daily production during the year was 9,744 barrels of crude oil and 44,370 MCF of gas which represents a slight increase for both oil and gas over 1976.

Canada

The Company's exploratory activities in Canada during 1977 were selectively concentrated in areas where a rapid to medium-term return might be expected and, of course, in those areas where TOTAL has a strong land position. The 44 wells drilled in western Canada resulted in 17 gas and 3 oil discoveries (see Drilling Activity table). Our major objectives have been the shallow Cretaceous gas reservoirs in east central Alberta and the Peace River Arch, the oil bearing Granite Wash in the Utikuma area and the Mesozoic/Paleozoic gas reservoirs in west central Alberta and British Columbia. This last area is known as the Elmworth area.

Elmworth attracted considerable industry attention during 1977. The area, which covers about 700 square miles, is about 250 miles northwest of Edmonton. A detailed map is included in this section. The industry experienced a drilling success ratio in the range of 80% in the Elmworth area for the year. Land sale prices early in 1977 averaged $50 to $150 per acre, but increased to over $1,100 per acre later in the year. The industry paid the Province of Alberta over $94 million for gas rights in this area in 1977. TOTAL has a large land position in the Elmworth region (in excess of 66,000 net acres and over 127,500 gross acres) mostly acquired in the late 1960's at low cost. We have added to our acreage position since the end of the year. The Company drilled seven wells in the area during 1977 and early 1978, six of which found gas reservoirs. The wells are still in the process of being evaluated. It is premature to project ultimate reserves but the potential of the region appears to be very good.

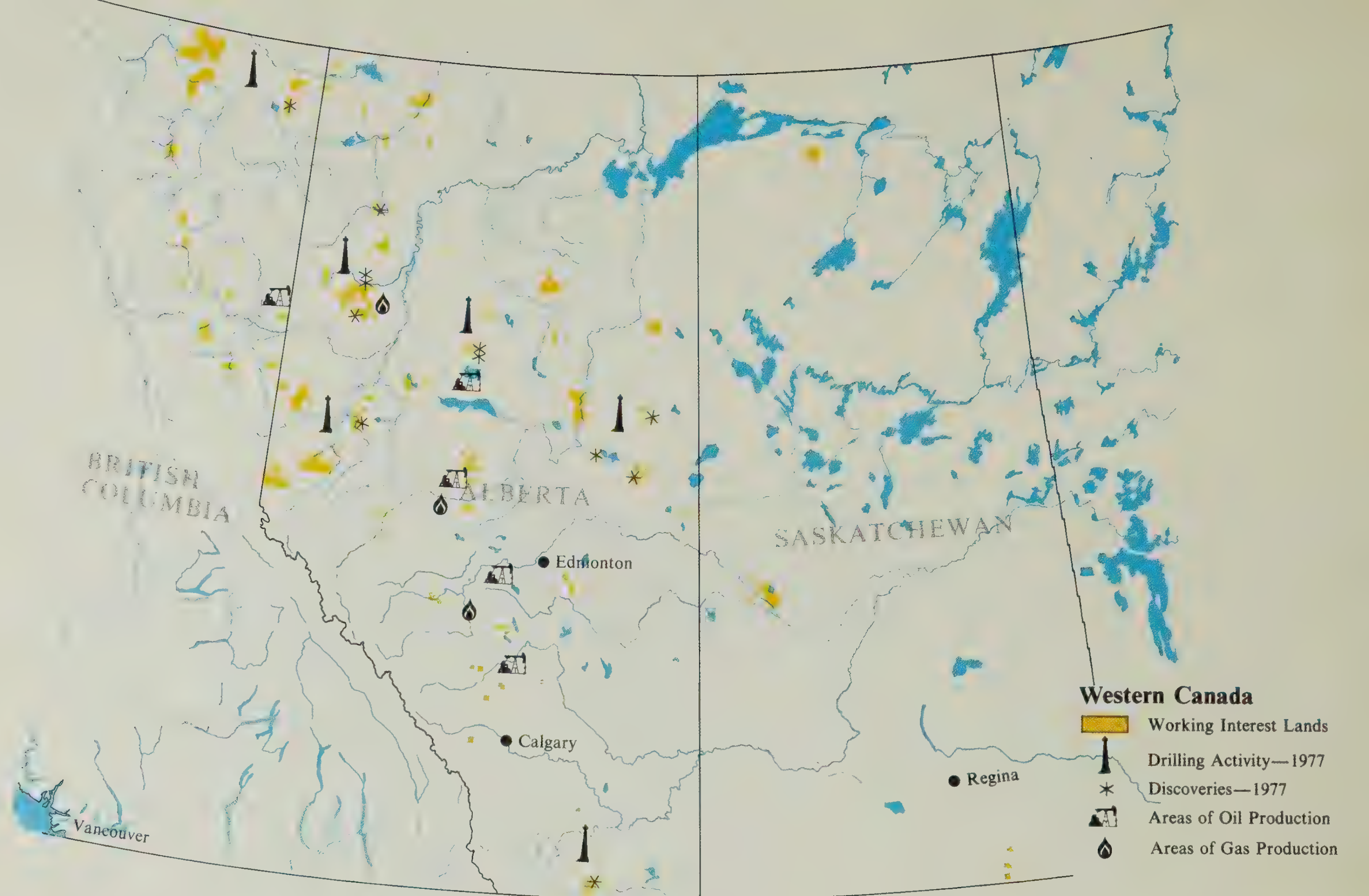
While there is currently a great amount of shut-in gas in Alberta and British Columbia, recent economic changes and political developments between Canada and the U.S. and the pressure of new discoveries might be expected to lead to substantial new markets, such as exports to the U.S., in the next two to four years. Such a development would add materially to TOTAL's natural gas sales.

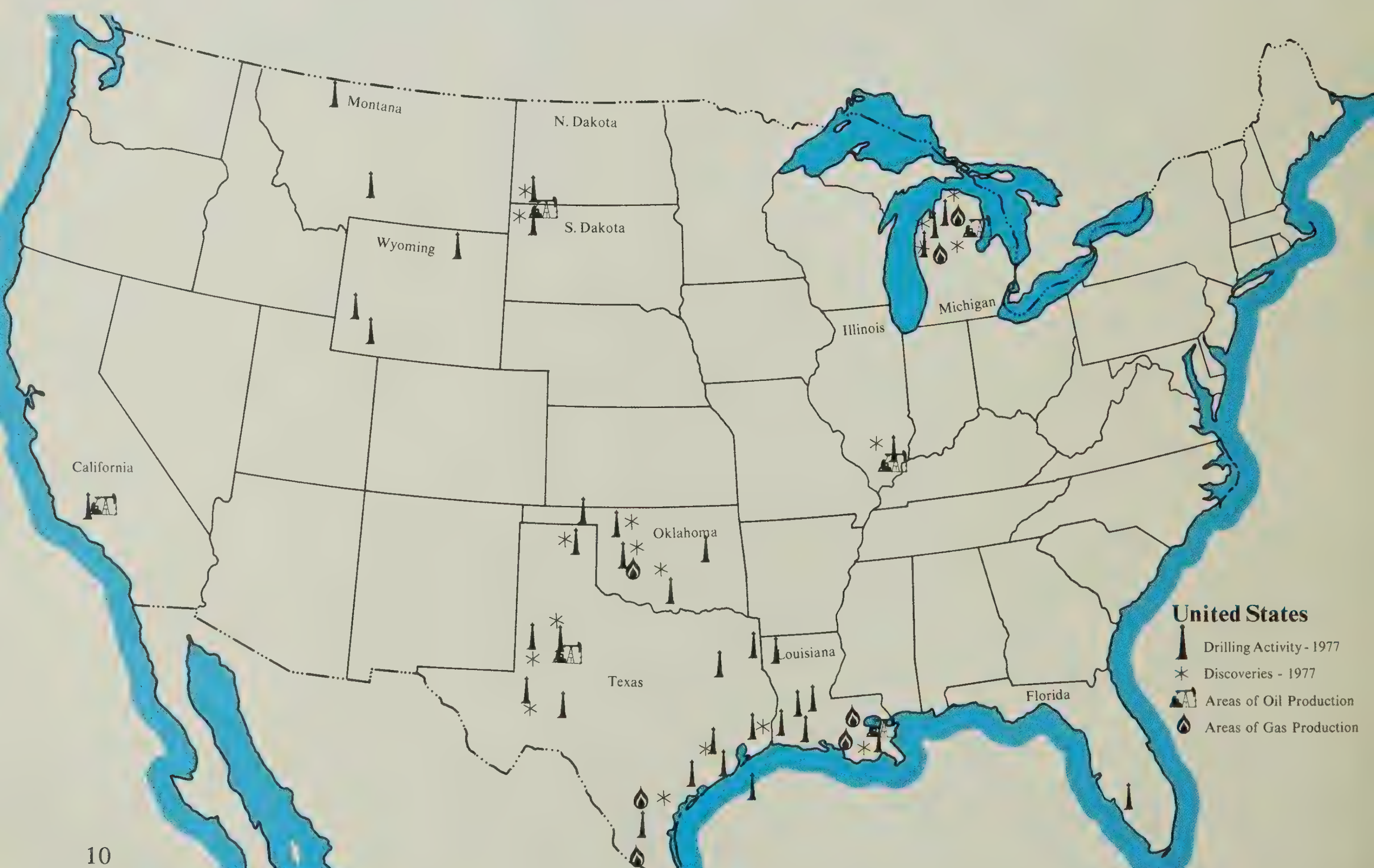
We continue to devote a moderate share of our resources to longer-term ventures. An experimental project for in-situ recovery of heavy oil in the North Battleford area of Saskatchewan is now in its fourth year. In 1977, Saskatchewan Oil and Gas Corporation (Saskoil), which is owned by the Saskatchewan Provincial Government, joined TOTAL and Texasgulf, Inc., in the project. Each participant has an equal one-third interest. The monies received from Saskoil for its participation are currently being used to winterize the plant and make it a year-round operation in order to reach the economic break-even point in producing this expensive oil.

Our second long-term venture, offshore Labrador exploration, was at a standstill through all of 1977 because of the jurisdictional dispute between the federal

DRILLING ACTIVITY

	1977		1976	
Exploratory Wells	Gross	Net	Gross	Net
Canada				
Oil	3	1.16	1	.50
Gas	15	4.11	15	6.99
Dry/Suspended	24	7.89	15	5.27
	42	13.16	31	12.76
United States				
Oil	15	1.86	17	3.91
Gas	9	1.69	13	3.93
Dry/Suspended	53	10.37	56	13.65
	77	13.92	86	21.49
Total Exploratory Wells	119	27.08	117	34.25
Development Wells				
Canada				
Oil	—	—	6	1.62
Gas	2	1.50	2	.30
Dry/Suspended	—	—	—	—
	2	1.50	8	1.92
United States				
Oil	54	7.13	44	10.48
Gas	18	.82	18	2.01
Dry/Suspended	44	6.40	27	4.46
	116	14.35	89	16.95
Total Development Wells	118	15.85	97	18.87
Total Wells	237	42.93	214	53.12


BRITISH
COLUMBIA
ALBERTA
SASKATCHEWAN
Edmonton
Calgary
Regina
Vancouver
Western Canada
Working Interest Lands
Drilling Activity—1977
Discoveries—1977
Areas of Oil Production
Areas of Gas Production


Montana
N. Dakota
S. Dakota
Wyoming
Michigan
Illinois
California
Oklahoma
Texas
Louisiana
Florida
United States
Drilling Activity - 1977
Discoveries - 1977
Areas of Oil Production
Areas of Gas Production

government and the Province of Newfoundland. TOTAL is a 5% participant in the Labrador Group. At present, it is not possible to predict whether 1978 will witness a resumption of meaningful activity in this venture.

Production of crude oil in Canada decreased slightly in 1977 from 1976 due essentially to proration imposed by the Canadian government. Gas sales increased approximately 11% as previous discoveries were turned into production (see Production Statistics table). Net revenues from oil and gas increased 18% over 1976. As can be seen from the table of Production Statistics, the average unit revenue received for crude oil and natural gas increased significantly in 1977. However, gross revenues are reduced by high provincial royalties averaging close to 40%. The wellhead price of crude oil was increased by $.75 per barrel on January 1, 1977 and by $1.00 per barrel on July 1, 1977. A further increase of $1.00 per barrel became effective January 1, 1978, bringing the average wellhead price to $11.75 per barrel. Additional $1.00 per barrel increases are expected on July 1, 1978 and January 1, 1979. Natural gas prices increased proportionally and resulted in an average increase of $.17 per MCF. The government's policy of gradually escalating oil and gas prices to world levels has improved returns significantly, encouraged the industry and resulted in the expansion of exploratory activities.

Our remaining oil reserves in Canada at year-end were 28.18 million barrels and natural gas reserves were 190.39 billion cubic feet. At current rates of production, these oil reserves represent approximately 15 years of production. Gas reserves represent approximately 28 years of production. The year-end reserves include Apco's Canadian producing reserves which were acquired on December 20, 1977. Most of the Apco producing properties are located in areas in which TOTAL already operates.

United States

As indicated in the Drilling Activity table, TOTAL's activity in the U.S., including wholly-owned Hanover Petroleum Corporation, was at a high level. TOTAL and Hanover participated in 193 wells during 1977. The Company's exploratory objective in the U.S. continues to be prospects offering rapid return with a limited financial risk in each individual venture. Hanover's exploration activities continue to be essentially in conjunction with public drilling programs which Hanover structures, markets and manages. These programs offer good leverage for TOTAL's exploratory exposure in the U.S.

Our Michigan exploration program continued in 1977 with 9 discoveries from 18 wells. At year-end 1977, TOTAL had interests in 55 producing wells in Michigan. Our activity in Michigan's Niagaran reef play will continue at the same level during 1978. Hanover continued development of the R.K. Devonian field in Martin County, West Texas during the past year. Net production to Hanover and its drilling programs is now approximately 600 barrels of oil per day. The continuing development program in this field, in which our interests

PRODUCTION STATISTICS

Crude Oil Production (before royalties)	1977 Bbls.	1977 BPD	1977 Revenue per Bbl. (i)	1976 Bbls.	1976 BPD	1976 Revenue per Bbl. (i)
Canada	1,928,618	5,284	$9.75	1,936,593	5,340	$8.63
United States (ii)	1,627,932	4,460	$10.48	1,172,109	4,371	$10.16
Total	3,556,550	9,744		3,108,702	9,711	

Natural Gas Sales (before royalties)	1977 MCF	1977 MCFPD	1977 Revenue per MCF (i)	1976 MCF	1976 MCFPD	1976 Revenue per MCF (i)
Canada	6,876,228	18,839	$1.31	6,202,447	16,950	$1.14
United States (ii)	9,318,672	25,531	$1.34	7,378,553	26,180	$1.11
Total	16,194,900	44,370		13,581,000	43,130	

(i) Average revenue in U.S. Dollars, before royalties, received per barrel or MCF.

(ii) Includes Hanover Petroleum Corporation for full year in 1977 and for eight months in 1976. Daily rates reflect Hanover rate for eight months in 1976.

range from 8% to over 60%, will carry through 1978. At the Kaplan deep gas prospect in Vermillion Parish, Louisiana, another successful gas well, the Broussard No. 1, was drilled by Hanover in 1977 and is expected to be on stream in early 1978. Two additional wells, with objectives in excess of 17,000 feet, are scheduled during 1978. Due to lack of drilling rigs, no follow-up well was drilled to the gas discovery made in early 1977 in Block 755 in the South Texas offshore waters. TOTAL has a 10% working interest in this area and another well is scheduled for the first half of 1978. A seismic program is planned in 1978 on our overthrust belt acreage in Wyoming, acquired in 1977 on the trend of recent industry discoveries.

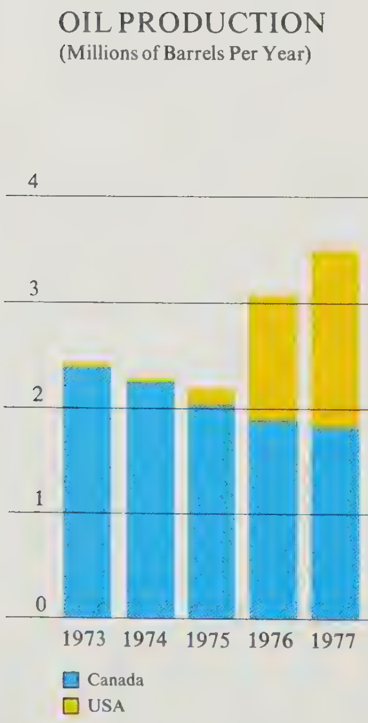
TOTAL's U.S. production of crude oil increased 39% in 1977 over 1976. Gas sales increased 26%. These increases result primarily from the inclusion of Hanover Petroleum Corporation's production for a full year as opposed to eight months in 1976. Based on daily rates, crude production increased marginally while gas sales decreased slightly (see Production Statistics table).

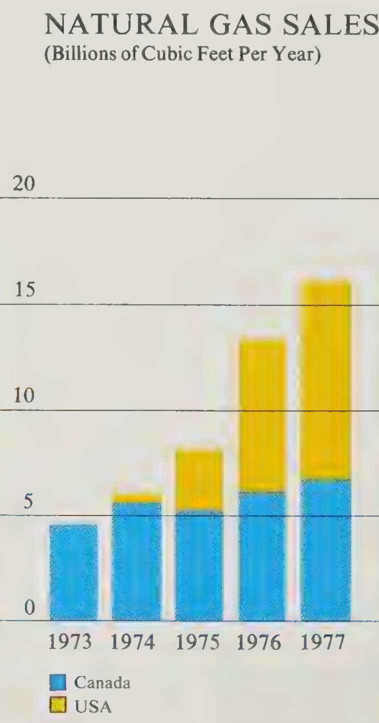
"Upper tier" oil represents approximately 80% of our production in the U.S. Between January and March 1977, "upper tier" oil prices were rolled back $.65 per barrel. This continued the government's actions, required by the Energy Policy and Conservation Act of December 1975, which had caused domestic oil prices to be frozen on July 1, 1976. The price was finally allowed to escalate again in September 1977 and increased $.83 per barrel over the last four months of the year. The price of "lower tier" oil, which had also been frozen, was allowed to increase $.11 per barrel after September. As indicated in the table of Production Statistics, these regulatory constraints caused our average unit revenue received for crude oil during the year to be almost static compared to 1976. TOTAL sells most of its natural gas in the presently non-regulated intrastate markets. Average unit revenue received for natural gas increased approximately 21% over 1976. Based upon legislation existing at the beginning of 1978, modest price increases in oil and gas may be expected during the coming year.

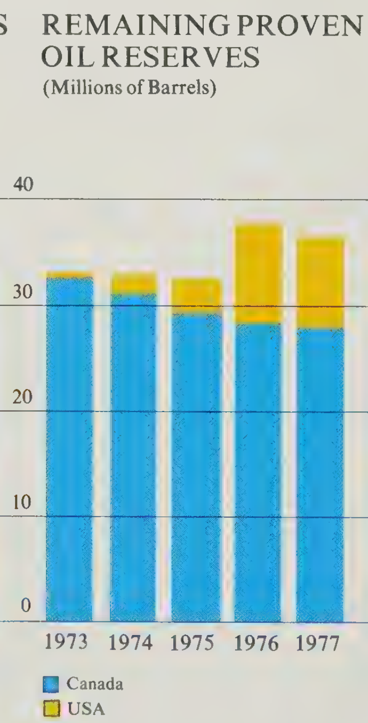
Our remaining oil reserves in the U.S. at year-end were 8.61 million barrels and natural gas reserves were 59.86 billion cubic feet. At current rates of production, these oil reserves represent approximately 5 years of production. Gas reserves represent approximately 6 years of production. This illustrates the rapid rate of depletion of onshore U.S. fields, and the difficulty of replacing production, in spite of a very active drilling program and a reasonable rate of success. However, prices currently received for new oil and new intrastate gas still provide an adequate return on our exploration investment which is our main criterion.

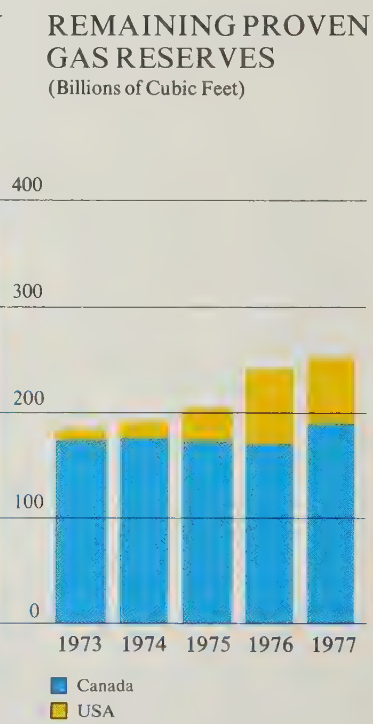
Outlook

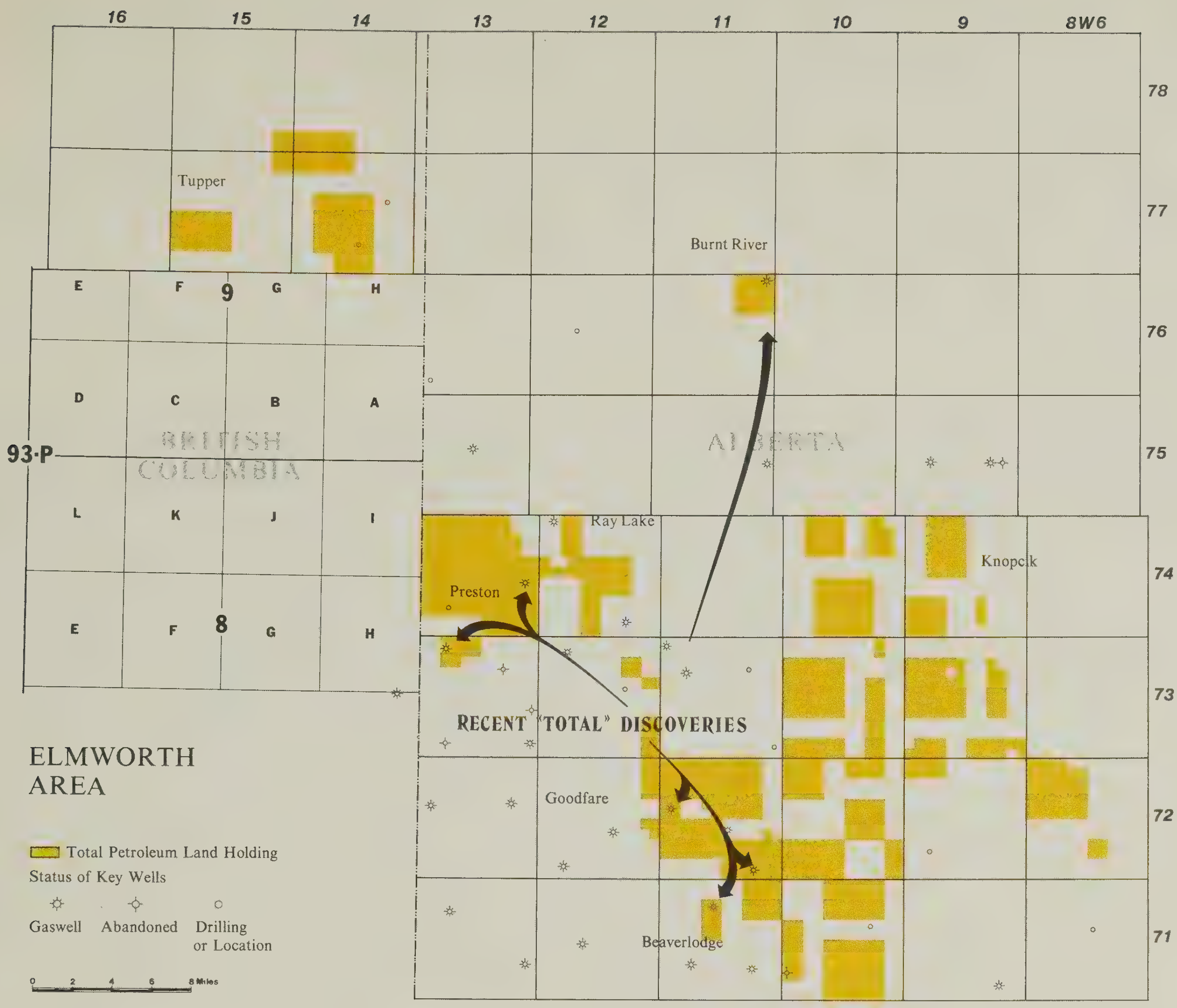
Our exploration program for both Canada and the U.S. in 1978 is again an ambitious one with overall expenditures in the same order of magnitude as in 1977. After several years of uncertainty, prospects now appear particularly promising in western Canada. TOTAL has maintained a strong land position in western Canada for many years (see Land Holdings table). This land position, the recent discoveries (particularly in the Elmworth area), the likely prospects of new natural gas markets opening up in the near term, and the government's oil and gas pricing policies all enhance the value of our Canadian exploration position. Future years should see continuing strong increases in our funds generated from Canadian operations. With a relatively small and flexible exploration staff, we will continue to be alert to new exploration opportunities and attractive potential acquisitions in North America.





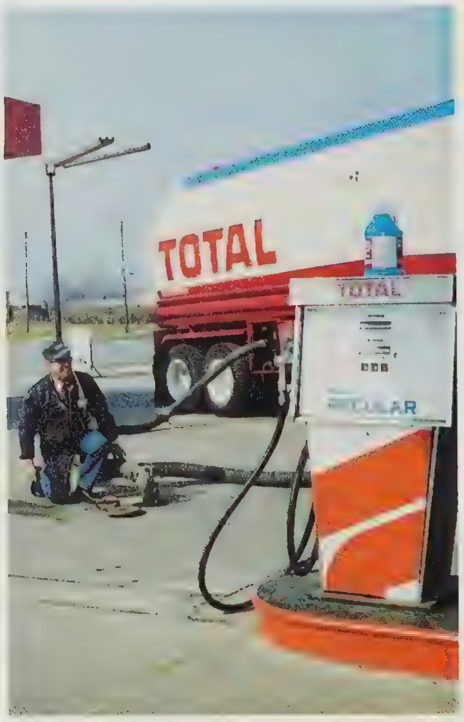






CONSOLIDATED LAND HOLDINGS ON DECEMBER 31, 1977
(Acres)

	Petroleum and Natural Gas Leases		Reservations, Permits and Licenses		Total	
	Gross	Net	Gross	Net	Gross	Net
British Columbia	468,818	156,313	241,140	64,922	709,958	221,235
Alberta	1,233,953	665,605	383,304	225,729	1,617,257	891,334
Saskatchewan	76,031	26,810	3,840	1,280	79,871	28,090
Ontario	43,166	21,583	—	—	43,166	21,583
Northwest Territories and Arctic	82,111	54,972	1,079,466	330,995	1,161,577	385,967
Labrador (Offshore)	—	—	28,480,537	1,424,026	28,480,537	1,424,026
Canada	1,904,079	925,283	30,188,287	2,046,952	32,092,366	2,972,235
Michigan	449,144	243,941	—	—	449,144	243,941
Texas (Onshore)	229,026	44,500	—	—	229,026	44,500
Texas (Offshore)	34,560	3,456	—	—	34,560	3,456
Louisiana	30,752	2,459	—	—	30,752	2,459
Rocky Mountain Area	1,710,376	346,213	—	—	1,710,376	346,213
All Other States	187,213	87,129	—	—	187,213	87,129
United States	2,641,071	727,698	—	—	2,641,071	727,698
Total	4,545,150	1,652,981	30,188,287	2,046,952	34,733,437	3,699,933


TOTAL
TOTAL
REGULAR

Refining and Marketing

TOTAL's refining and marketing operations made a sizeable contribution to the Company's overall success in 1977. Cash flow from operations was $17.6 million, up 40% from 1976. Crude oil runs at the Alma refinery were nearly 15 million barrels for the year, averaging 41,074 barrels per day which was an increase of 2,550 barrels per day over 1976. The $13 million refinery expansion and modernization program, initiated in late 1975, neared completion at year-end on schedule and on budget. Sales volumes were 751 million gallons, up 2.3% from 1976. Gasoline sales at company-operated stations continued to increase during 1977, both overall and on an individual station basis. And, of major significance, the Company entered into an agreement with Apco Oil Corporation to purchase Apco's 46,000 BPD refinery located at Arkansas City, Kansas and its associated crude and refined product pipelines and terminals.

Refining

While attaining record crude oil runs in 1977, refinery operations began to reflect the results expected from the $13 million improvement program. The primary objective of the program is to increase the gasoline yield of the refinery and, thereby, significantly increase cash flows from the operation. Completion of the program will raise gasoline yield to approximately 65% of crude oil charge, compared to historic yields of 50-52%, while virtually eliminating production of lower sales value residual fuel and asphalt. The Alma refinery, being the only sizeable refinery in central Michigan, has a geographical advantage to supply a market area in which total demand exceeds our refinery production. The increased gasoline production can be exchanged to supply our customers in other areas where we currently purchase products.

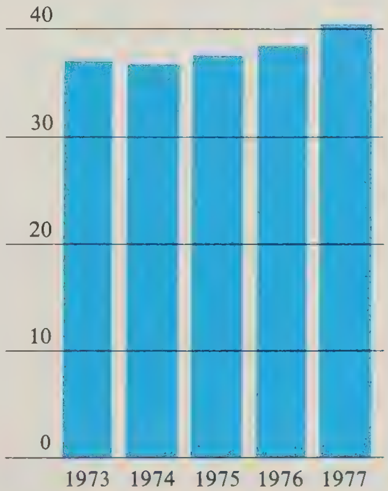
The major phases of the program, involving the Fluid Catalytic Cracking and associated units, were "tied-in" during the last quarter and helped to improve gasoline yield for the year to approximately 54% of crude charge versus approximately 52% in 1976. The remaining phases of the program, involving the Alkylation unit, are to be completed during the first quarter of 1978 and gasoline yield for the year is expected to be in excess of 60%. The upgrading investment will also reduce energy consumption by 25%, reduce sulphur emissions below regulatory standards, allow the refinery to comply with the federally mandated lead-phase-down program and increase production of lead-free gasoline in order to satisfy increasing market demand.

Supply

Competitive crude oil cost is vital to TOTAL. The U.S. government's "entitlements" program, which has the objective of equalizing crude oil costs between refineries, falls short of that objective. We must therefore continually strive to find highly reliable, lower cost, domestically produced crude oil. The problem has been compounded over the past few years by the Canadian government's program of reducing crude oil exports to the U.S. During 1973, crude oil runs at the Alma refinery were over 50% Canadian crude oil. Today, we are able to operate the refinery at capacity with 100% domestic crude oil. But, even though the crude oil charge is domestic, it is not at 100% domestic prices. Our strategy for solving the dual problem of reduced Canadian crude oil supply and high cost other foreign crude oil has been three-pronged. First, we have purchased costly foreign crude oil and have exchanged it for domestic crude oil produced close to the refinery. Second, we have increased our efforts to make direct purchases of domestically produced crude oil. Third, we have attempted to direct a greater volume of our own domestic production to supply our refinery need. Through these efforts we have been able to maintain an adequate supply of crude oil at competitive costs.

In order to balance supply with TOTAL's market demand for gasoline, 3,400,000 barrels of gasoline were

CRUDE OIL REFINED
(Thousands of Barrels Per Day)



purchased from other refiners during 1977. As discussed in the Refining section, future purchases will be partially displaced by the increased gasoline production at the Alma refinery.

A 14-mile gas liquids pipeline was constructed during 1977, at a cost of $600,000, to tie the Alma refinery into another company's natural gas liquids pipeline. The new line will accommodate the direct sale, to a volume purchaser, of the increased propane and ethane production resulting from the refinery upgrading project.

Marketing

At 751 million gallons, a new record was achieved in overall sales volume during 1977. The chart in this section shows that sales have continued to increase since 1973, and that all the sales growth in 1977 was in gasoline, the highest sales value product, while sales of middle distillates remained static and those of the lower sales value industrial products declined slightly.

Prices for our principal products were firm through the first eight months of the year. Thereafter, gasoline prices decreased by more than the normal seasonal adjustment and light and residual fuel oil prices did not increase in line with normal seasonal increases, partly because they had remained relatively firm during the course of the year. This weakening of prices during the latter part of the year was a result of a generally high level of inventories for all products in our marketing area and throughout the United States. Despite this situation, price controls and allocation regulations remain in force on gasoline, propane, and commercial jet fuels, causing ever increasing distortions in the market.

Profitability and sales volumes at company-operated service stations, under the TOTAL brand in the Detroit area and the BEST brand, largely in outstate Michigan, continued to improve. Several years ago we commenced converting BEST service stations to self-service operation on an experimental basis. We found that this type of operation at selected stations enabled us to offer more competitive prices to the public while increasing profitability as a result of cost savings and the increased sales volumes involved. The program was therefore expanded and by the end of 1977 about 75% of the BEST service station network had been converted to self-service. During 1977 we began converting suitable TOTAL stations in the Detroit area to self-service operation. We intend to accelerate these conversions during 1978 so that about 60% of the Detroit area network will be operating on a self-serve basis by year-end.

1977 saw continued progress in implementing our program of phasing out company-operated bulk plants in outstate Michigan by selling them to independent jobbers who continue to sell TOTAL branded products. We expect this program to be completed in 1978.

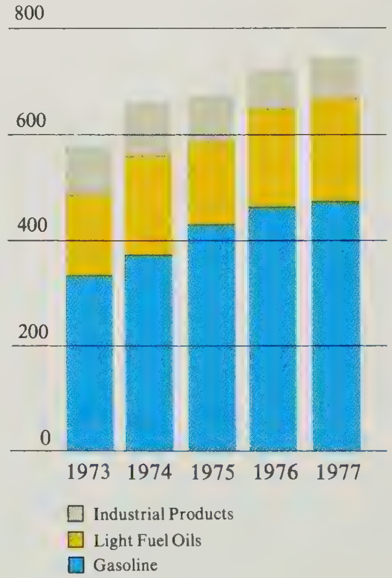
Our objectives in respect to gasoline sales were:

- to increase retail sales through the company-operated service station network,
- to increase branded jobber sales at the expense of company-operated bulk plant sales,
- to maintain sales volumes to unbranded independent distributors.

These objectives were all achieved as the following table shows.

	Gasoline Sales Volumes (Millions of Gallons)			
	1977		1976	
	Volume	%	Volume	%
Company-operated service stations	153	31.9	127	27.7
Company-operated bulk plants	33	6.9	48	10.4
Branded jobbers	92	19.3	79	17.2
Unbranded distributors	201	41.9	205	44.7
	479	100.0	459	100.0

REFINED PRODUCT SALES
(Millions of Gallons)



Sales volumes in the Michigan market are not expected to increase significantly in 1978. Our objective will be to maximize gasoline and middle distillate sales to the more profitable channels of trade and to substantially decrease sales of lower value industrial products in line with the reduced production of those products discussed in the Refining section.

Apco Acquisition

As pointed out in the President's message to our shareholders, we are optimistic regarding long-term profitability of refining and marketing in the United States. We expect the operation of the Arkansas City, Kansas refinery, upon completion of the purchase, to make a contribution to our results comparable to our Michigan refining and marketing operation.

The Arkansas City facility will more than double the Company's refining capacity. This refinery was recently modernized, with a new crude unit and catalytic reformer placed in operation in 1974 and 1975 respectively. The facility is capable of manufacturing a high yield (approximately 65%) of gasoline. Agreements relating to the current supply of domestic crude oil for the Arkansas City refinery will be transferred from Apco to TOTAL. Crude oil supply to the refinery is expected to be entirely domestic. The control of this domestic crude oil will provide greater flexibility in our overall crude oil supply strategy.

The purchase of the Arkansas City refinery and associated pipelines and terminals, from which we will continue to supply Apco's traditional customers in eleven mid-continent states, will enhance our product distribution flexibility. Although this acquisition will substantially increase sales volumes–from 750 million currently, to approximately 1,400 million gallons per year–and the geographic spread of our marketing activities, the operating expenses will be relatively small. This results from the decision to market all gasoline and most fuel oils through branded jobbers, as we consider that the markets involved are well suited to this type of distribution.

All of the field operations will be staffed by personnel previously employed by Apco Oil Corporation. In addition to the refinery operations located in Arkansas City, an office has been established in Oklahoma City, Oklahoma from which the mid-continent supply and marketing functions will operate. Most administrative functions will be performed at corporate headquarters in Alma. In order to achieve maximum efficiency from the combined operation, each functional area will be under the responsibility of TOTAL's respective Vice-President. We look forward with confidence to achieving good results from this new venture.

Outlook

The year 1978 may well prove to be a very demanding one for the industry and TOTAL. Adjusting to our expanded operations will not be done without some "growing pains". The current squeeze on product margins is expected to continue well into 1978 and will require constant attention in order to maximize returns. Possibly the most demanding problem to be faced is the unpredictable and often inconsistent governmental regulation. Current Congressional debate on national energy policy may very well result in another wave of changing and complicated regulations.

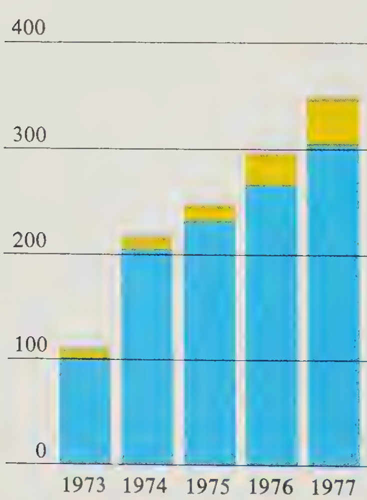
Summary of Operations

TOTAL®

OPERATIONS	1977	1976	1975	1974	1973
Exploration and Production					
Crude oil and condensate (thousands of barrels)—					
Canada					
Proven reserves at year-end (i)	28,176	29,110	29,409	31,167	32,637
Production during year	1,929	1,937	2,044	2,237	2,398
United States					
Proven reserves at year-end (i)	8,614	9,390	3,505	1,195	792
Production during year	1,628	1,172	181	70	15
Natural gas (millions of cubic feet)—					
Canada					
Proven reserves at year-end (i)	190,389	176,040	177,163	180,015	176,984
Sales during year	6,876	6,202	5,418	5,825	4,883
United States					
Proven reserves at year-end (i)	59,860	68,360	26,696	17,290	12,210
Sales during year	9,319	7,379	2,565	645	—
Gross land holdings (thousands of acres)—					
Canada	32,092	32,031	32,566	33,531	35,672
United States	2,641	2,547	1,464	1,273	385
Net land holdings (thousands of acres)—					
Canada	2,972	2,972	3,241	3,795	4,059
United States	728	792	508	409	208
Refining and Marketing					
Crude oil refined (thousands of barrels)	14,992	14,098	13,729	13,494	13,566
Manufactured gasoline (thousands of barrels)	8,119	7,285	7,213	6,568	7,235
Refined product sales (thousands of barrels)	17,884	17,478	16,329	15,754	14,122
Gasoline sales (thousands of barrels)	11,407	10,986	10,094	9,066	8,130
Service stations owned or leased long term	176	204	220	233	250
Total outlets	697	691	714	699	685

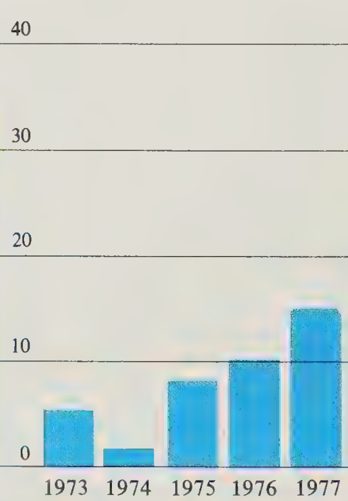
(i) Proven reserves net of estimated future royalty deductions were 15,974,563 barrels in Canada and 7,053,592 barrels in the U.S., and 132,591 million cubic feet in Canada and 48,825 million cubic feet in the U.S. at year-end 1977.

REVENUE
(Millions of U.S. Dollars)

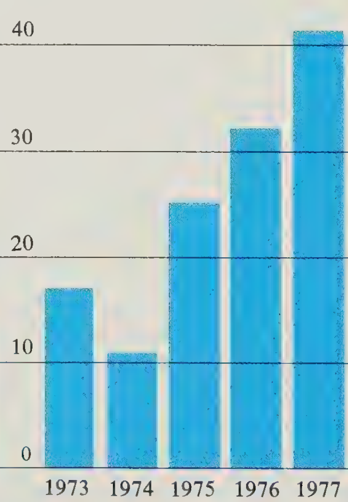


Sales of Refined Products
Sales of Crude Oil and Natural Gas
Other Income

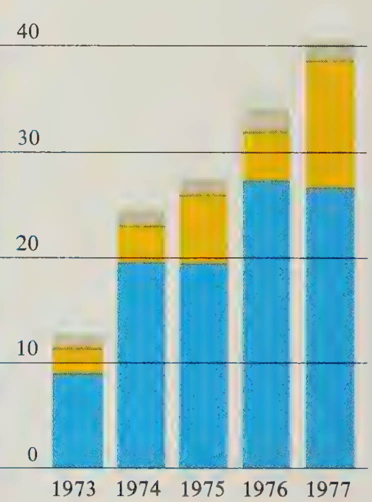
NET INCOME
(Millions of U.S. Dollars)



FUNDS PROVIDED BY OPERATIONS
(Millions of U.S. Dollars)



CAPITAL EXPENDITURES
(Millions of U.S. Dollars)



Exploration and Production
Manufacturing, Supply and Transportation
Marketing and Administrative

FINANCIAL

(In Thousands of U.S. Dollars Except Per Share Amounts)

	1977	1976	1975	1974	1973
Funds Provided by Operations (i)					
Exploration and Production	$ 32,030	$ 24,736	$ 12,395	$ 8,976	$ 6,318
Refining and Marketing	17,613	12,632	16,756	4,175	15,380
Other income	1,241	1,351	717	1,408	535
Unallocated administrative expenses	(1,535)	(1,079)	(1,074)	(944)	(899)
Interest expense	(7,392)	(6,207)	(3,109)	(2,601)	(3,767)
Income taxes (payable) refundable	(300)	1,000	—	—	—
	$ 41,657	$ 32,433	$ 25,685	$ 11,014	$ 17,567
Summary of Earnings					
Revenue:					
Net sales of refined products and other	$306,698	$265,742	$232,781	$207,527	$102,455
Net sales of crude oil, natural gas and other	41,530	31,625	14,512	10,451	7,611
Other income (expenses) unallocated	1,241	1,351	717	1,408	535
	349,469	298,718	248,010	219,386	110,601
Costs and Expenses:					
Purchased crude oil, products and merchandise	240,338	211,110	177,442	168,925	61,001
Operating, marketing and administrative—					
Exploration and Production	9,500	6,889	2,117	1,475	1,293
Refining and Marketing	48,747	42,000	38,583	34,427	27,507
Depreciation and depletion—					
Exploration and Production	13,821	10,049	4,996	4,621	3,682
Refining and Marketing	3,272	3,848	3,841	3,084	3,248
Unallocated administrative	1,535	1,079	1,074	944	899
Interest	7,392	6,207	3,109	2,601	3,767
Income taxes	9,900	7,090	7,850	1,441	4,071
	334,505	288,272	239,012	217,518	105,468
Net income	$ 14,964	$ 10,446	$ 8,998	$ 1,868	$ 5,133
Net income per share	$ 1.17	$ .82	$ .70	$ .10	$ .51
Capital Expenditures (ii)					
Exploration and Development:					
Acquisition of oil and gas rights	$ 6,383	$ 2,628	$ 4,510	$ 10,936	$ 1,864
Rentals	1,636	1,534	1,199	935	808
Exploratory expenses	3,611	4,963	4,968	3,564	2,487
Drilling	11,447	13,881	5,932	3,055	3,474
Production and other equipment	3,339	2,613	1,239	1,419	612
Producing properties	639	2,045	2,000	—	—
	27,055	27,664	19,848	19,909	9,245
Refining	11,140	3,912	1,635	1,734	1,184
Supply and Transportation	1,024	736	4,573	1,515	883
Marketing	684	1,238	1,331	1,149	1,009
Administrative	395	971	243	247	371
Total	$ 40,298	$ 34,521	$ 27,630	$ 24,554	$ 12,692
Financial Statistics					
(Long-term debt) ÷ (long-term debt + shareholders' equity)	.39	.37	.24	.19	.20
Shareholders' equity	$131,017	$117,144	$105,206	$ 97,054	$ 96,029
Shareholders' equity per share (iii)	$10.24	$8.95	$7.82	$7.03	$6.92
Number of registered shareholders	6,211	7,317	7,450	7,511	8,091

(i) Net income plus income charges not affecting working capital in the year. Refer to Consolidated Statement of Changes in Financial Position for other sources and uses of funds.

(ii) Excludes $47,611 related to the acquisition of Hanover Petroleum Corporation in 1976 and $9,850 related to the acquisition of certain assets from Apco Oil Corporation in 1977.

(iii) Shareholders' equity in excess of par value of preferred shares divided by common shares outstanding at the end of the year.

Consolidated Statements of Income and Retained Earnings

Total Petroleum (North America) Ltd. and Subsidiaries

(U.S. Dollars)

INCOME	Year Ended December 31	
	1977	1976
Revenue:		
Net sales of refined products	$306,135,000	$264,472,000
Net sales of crude oil and natural gas	41,146,000	31,374,000
Other income	2,188,000	2,872,000
	349,469,000	298,718,000
Expenses:		
Purchased crude oil, products and merchandise	240,338,000	211,110,000
Operating	37,501,000	30,190,000
Marketing and administrative	22,281,000	19,778,000
Depreciation and depletion	17,093,000	13,897,000
Interest on long-term debt	7,024,000	6,014,000
Other interest	368,000	193,000
Income taxes	9,900,000	7,090,000
	334,505,000	288,272,000
Net income for the year	$ 14,964,000	$ 10,446,000
Net income per share	$1.17	$.82

RETAINED EARNINGS	1977	1976
Balance, beginning of year	$ 33,552,000	$ 23,951,000
Net income for the year	14,964,000	10,446,000
	48,516,000	34,397,000
Dividends:		
Series A Preferred shares	(845,000)	(845,000)
Common shares	(475,000)	–
Balance, end of year	$ 47,196,000	$ 33,552,000

See Notes to Consolidated Financial Statements

Consolidated Balance Sheet

Total Petroleum (North America) Ltd. and Subsidiaries

(U.S. Dollars)

ASSETS	December 31 1977	December 31 1976
Current Assets:		
Cash	$ 5,311,000	$ 5,624,000
Short-term investments	11,247,000	3,711,000
Accounts and notes receivable, less allowance for doubtful accounts of $492,000 (1976–$443,000)	28,080,000	23,250,000
Inventories of purchased crude oil and products	18,351,000	15,835,000
Inventories of merchandise, materials and supplies	3,786,000	3,469,000
Prepaid expenses and other	6,464,000	5,963,000
	73,239,000	57,852,000
Short-Term Investments Held for Refinery Acquisition	40,000,000	–
Long-Term Receivables and Other Assets	3,337,000	3,045,000
Property, Plant and Equipment, Net	234,614,000	203,974,000
	$351,190,000	$264,871,000
LIABILITIES, DEFERRED CREDITS AND SHAREHOLDERS' EQUITY:		
Current Liabilities:		
Accounts and notes payable	$ 37,285,000	$ 33,814,000
Accrued taxes	4,007,000	4,352,000
Other accrued liabilities	4,088,000	1,242,000
Current portion of long-term debt	2,966,000	9,840,000
	48,346,000	49,248,000
Long-Term Debt	84,509,000	69,579,000
Deferred Credits:		
Deferred income tax provision	37,020,000	27,420,000
Deferred production income and other	50,298,000	1,480,000
Shareholders' Equity:		
Capital Stock –		
Series A Preferred shares	23,929,000	24,160,000
Common shares	9,947,000	9,880,000
Contributed surplus	49,945,000	49,552,000
Retained earnings	47,196,000	33,552,000
	131,017,000	117,144,000
	$351,190,000	$264,871,000

Approved on Behalf of the Board:

Director

Director

See Notes to Consolidated Financial Statements

Consolidated Statement of Changes in Financial Position

Total Petroleum (North America) Ltd. and Subsidiaries

(U.S. Dollars)

	Year Ended December 31 1977	1976
Funds were provided by:		
Operations–		
Net income for the year	$ 14,964,000	$ 10,446,000
Income charges not affecting working capital in the year:		
Depreciation and depletion	17,093,000	13,897,000
Deferred income taxes	9,600,000	8,090,000
Total provided by operations	41,657,000	32,433,000
Additional long-term borrowings	51,055,000	49,208,000
Proceeds from sales of future production	48,954,000	1,740,000
Sales of properties	2,415,000	564,000
Issuance of equity securities	229,000	2,337,000
Other	–	605,000
Total funds provided	144,310,000	86,887,000
Funds were used for:		
Capital expenditures–		
Petroleum and natural gas interests and production equipment	36,905,000	75,156,000
Refining, marketing and transportation	12,848,000	5,886,000
Other	395,000	1,090,000
Long-term debt paid or reclassified to current liabilities	36,125,000	12,585,000
Short-term investments held for refinery acquisition	40,000,000	–
Dividends	1,320,000	845,000
Reduction of deferred production income	107,000	1,829,000
Other	321,000	–
Total funds used	128,021,000	97,391,000
Increase (decrease) in working capital	$ 16,289,000	$ (10,504,000)
Changes in components of working capital:		
Working capital, beginning of year	$ 8,604,000	$ 19,108,000
Increase (decrease) in current assets:		
Cash and short-term investments	7,223,000	(8,807,000)
Accounts and notes receivable	4,830,000	6,789,000
Inventories	2,833,000	(1,182,000)
Prepaid expenses and other	501,000	4,257,000
	15,387,000	1,057,000
(Increase) decrease in current liabilities:		
Accounts payable and other accrued liabilities	(6,317,000)	(6,382,000)
Accrued taxes	345,000	(1,158,000)
Current portion of long-term debt	6,874,000	(4,021,000)
	902,000	(11,561,000)
Working capital, end of year	$ 24,893,000	$ 8,604,000

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

1. ACCOUNTING POLICIES

The significant accounting policies followed by the Company and its subsidiaries are presented here to assist the reader in reviewing the financial information contained in this report.

Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiaries.

Foreign Currency Translation

The Company presents the consolidated financial statements in United States dollars because the majority of the transactions, and the major portion of the working capital and long-term debt of the consolidated companies, are in that currency. Canadian assets and liabilities representing cash and amounts owing to or by the Company are translated at the rate of exchange in effect at the end of the period. Other assets (such as inventories and property, plant and equipment) and deferred credits are translated at historical rates. Operating results for the period are translated at the monthly average rate of exchange during the year; depreciation and depletion included in operating results are translated at historical rates. Currency translation gains and losses, which are not material, are included in net income.

Inventories

Inventories are valued at the lower of cost or net realizable value. Cost of inventories of crude oil and refined products is determined by the last-in, first-out method. Cost of inventories of merchandise, materials and supplies is determined by the first-in, first-out method with respect to merchandise and by the average cost method for materials and supplies.

Property, Plant and Equipment

Property, plant and equipment is carried at cost.

All costs of exploring for and developing oil and gas reserves are capitalized and charged to operations over the life of estimated future production (proven reserves) on the unit-of-production method. Proceeds from disposals are applied against such cost (see Note 11).

Depreciation is provided using the straight-line method based on estimated useful lives of assets.

Maintenance and repairs are charged to expense in the year incurred. Renewals or betterments which materially extend the useful lives of the facilities are

charged to the asset account or to the related reserve for depreciation, as appropriate. Major revamping costs are charged to the asset account. The accumulated depreciation on these revamped facilities is retired against the related cost of the asset.

Generally, when depreciable properties are retired or otherwise disposed of, the costs of the assets are eliminated from the asset accounts, the related amounts of accumulated depreciation are eliminated from the reserve accounts, and the resulting profits or losses are included in the statement of income for the period.

For one subsidiary the costs of assets retired less salvage are charged to the reserve for depreciation accounts to conform with the requirements of a governmental regulatory commission.

Income Taxes

Income taxes included in the consolidated financial statements are computed on the basis of (reference is made to Note 6 for further details):

(i) not providing for taxes which would be payable upon transfer of undistributed earnings of subsidiaries since management believes that either such earnings will not be transferred in the foreseeable future or no tax expense would be incurred because of available credits or deductions;

(ii) providing deferred taxes under the tax allocation method of accounting for income taxes whereby the provision for income taxes each year is computed on the basis of depreciation, depletion and certain other charges recorded in the accounts rather than the related amounts claimed as deductions in the companies' tax returns.

Investment tax credits are applied as a reduction of income tax expense in the period realized.

Other

Excise taxes collected from customers are excluded from the Consolidated Statement of Income.

Sales of purchased crude oil are deducted from the related purchases in the Consolidated Statement of Income.

Pension plans cover substantially all of the Company's employees. Current cost and accruals for prior service costs (accrued over 30 years) are funded currently.

2. ACQUISITIONS

The Company, through a subsidiary, acquired Hanover Petroleum Corporation on April 30, 1976. Hanover is engaged in exploring for and developing oil and gas properties and organizing and managing private and public drilling programs. In exchange for outstanding shares the former Hanover shareholders received the aggregate of $18,387,000 cash, $17,395,000 of subordinated 11½% Guaranteed Sinking Fund Debentures (see also Note 4), warrants (valued by the Company at $2,242,000) to purchase 1,630,749 of the Company's Common shares for $10.00 per share, and a royalty interest in certain properties. The cost of the assets acquired, with cost being determined by the above mentioned payments to the previous shareholders, acquisition expenses incurred of $1,900,000 and liabilities assumed of $16,564,000, was attributed to the various assets based on fair market values. The aggregate increase in long-term debt in connection with the acquisition was $46,795,000.

Pursuant to an agreement dated August 19, 1977 the Company, on December 20, 1977, acquired certain producing petroleum and natural gas properties from Apco Oil Corporation for approximately $9.8 million. In addition to these Canadian properties, the Company will acquire a refinery and certain related pipeline, terminal and shipping facilities located in the United States from Apco upon the receipt of a required ruling from the Department of Energy. The purchase price for the United States properties of $53,600,000 plus expenses incurred in the acquisition will be allocated to the acquired assets based on fair market values. In the event that purchase of the United States assets is not completed, Apco may, at its option, repurchase the Canadian assets by refunding all monies received adjusted for operating results after December 20, 1977. The Company will also purchase inventories related to the acquired assets and accounts receivable from customers that Apco will assign to the Company. The estimated cost of the inventories and accounts receivable is $50,000,000. Because a more timely ruling from the Department of Energy was expected, the financing for the acquisition from Apco was partially completed in 1977. The proceeds received in advance of their need have been placed in short-term investments and, because of the intended future use of the monies, have been classified as a noncurrent asset in the Consolidated Balance Sheet.

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is as follows (see also Note 4 for debt secured by property and Note 5 for assets subject to production payment):

	1977	1976
Petroleum and natural gas interests	$197,491,000	$167,523,000
Production equipment	19,693,000	16,127,000
Refining	37,233,000	26,141,000
Marketing	32,547,000	33,899,000
Supply and transportation	15,980,000	15,150,000
Other	3,923,000	4,394,000
	306,867,000	263,234,000
Less—accumulated depreciation and depletion(1)	72,253,000	59,260,000
	$234,614,000	$203,974,000

(1) Including accumulated depletion related to petroleum and natural gas interests of $36,948,000 and $27,245,000 at December 31, 1977 and 1976, respectively.

4. LONG-TERM DEBT

The following summarizes the consolidated long-term debt:

	1977	1976
Notes payable:		
Due 1979, interest at prime rate plus 1½%	$ 4,000,000	$ 4,000,000
Due 1979, interest 8¼%	5,000,000	—
Due 1982, interest 8½%	20,000,000	—
Due 1983, interest 8⅝%	20,000,000	—
Notes payable in monthly installments (certain oil and gas properties pledged)	10,399,000	36,972,000
Guaranteed 11½% Sinking Fund Debentures due December 31, 1990 (subordinated)	17,334,000	17,334,000
First real estate mortgage notes due in quarterly installments of $175,000 at prime rate plus 1%	3,500,000	4,000,000
Other secured debt at 5½% to 9½%	7,242,000	9,463,000
Other debt, at prime rate plus ½% and 1½%	—	7,650,000
	87,475,000	79,419,000
Less—current maturities	2,966,000	9,840,000
	$ 84,509,000	$ 69,579,000

The Guaranteed 11½% Sinking Fund Debentures are payable by a subsidiary and guaranteed as to payment of principal and interest (on a subordinated basis) by the Company. The sinking fund provisions require annual payments sufficient to retire 10% of the outstanding principal balance from December 1981 through December 1988 with the remaining balance due on December 31, 1990. Notes payable in monthly installments at December 31, 1977 require monthly payments of $127,000 plus interest at prime rate plus ¾%.

Minimum annual maturities of long-term debt for the next five years are as follows:

1978 — $ 2,966,000
1979 — $11,998,000
1980 — $ 3,008,000
1981 — $ 4,781,000
1982 — $24,790,000

At December 31, 1977 the Company or its subsidiaries had unused commitments from various banks for future borrowings aggregating $63,900,000, of which $30,500,000 would be on a short-term basis. Borrowings under such agreements would be at interest rates ranging from the prime interest rate to the prime interest rate plus ¾%, or at various comparable Eurodollar rates. Commitment fees on the unused available credit range from ⅛% to ½%. Under terms of the commitment agreements, $23,400,000 will expire in 1978 and $20,500,000 in 1979.

5. DEFERRED PRODUCTION INCOME

In December, 1977, the Company carved out and sold production payments in substantially all of its U. S. and certain of its Canadian oil and gas producing properties for a total consideration of $48,708,000. The purchaser of the U. S. production payment will receive 75% of the revenues net of royalties from specified properties which will be applied to interest at the rate of 8¼% and to reduction of the primary sum. The purchaser of the Canadian production payment will receive 65% of revenues net of royalties from the specified properties which will be applied to interest at the rate of .85% above Canadian prime and to reduction of the primary sum.

If the primary sums are not reduced by more than certain stated amounts, the revenue percentages may be increased; but the purchasers may look only to revenues from the specified properties for both interest and the return of the primary sums.

The total minimum repayments of the primary sums expected under the conveyance agreements are as follows:

1978 — $10,400,000
1979 — $12,870,000
1980 — $11,990,000
1981 — $10,720,000
1982 — $ 2,728,000

6. INCOME TAXES

Under Canadian income tax law, most exploration and development expenditures, including resource property acquisition costs, are deductible on various bases which generally have the effect of permitting such deduction to be made for tax purposes in advance of their being charged off in the books. Capital cost allowances for depreciable assets are also deductible in advance of depreciation charged in the accounts. Tax laws in the United States contain provisions which may have a similar effect. As explained in Note 1, provision has been made in the accounts for the taxes deferred as a result of such deductions exceeding expenses charged in the income statement.

Investment tax credits are applied as a reduction of the tax expense, thereby reducing the expense to an amount below the statutory tax rate. Credits and special allowances in Canada similarly reduce taxes otherwise payable. Royalty and other payments to governments are not deductible for Canadian federal income tax purposes.

Income taxes in the Consolidated Statement of Income were as follows (in thousands of dollars):

	1977	1976
Canadian taxes currently payable (refundable)	$ 300	$(1,000)
Deferred tax provisions:		
U. S.	7,015	4,480
Canadian	2,585	3,610
	$ 9,900	$ 7,090

Income tax expense is at rates other than the statutory U. S. income tax rate as follows (in thousands of dollars):

	1977	1976
Income before income taxes	$24,864	$17,536
Statutory U. S. rate	48%	48%
Tax provision at statutory rate	11,935	8,417
Differences:		
Canadian taxes at rates higher (lower) than U. S. rates	(365)	123
State income taxes	130	50
Investment tax credits	(1,000)	(700)
Amortization of additional tax basis on properties distributed as a dividend by a subsidiary	(800)	(800)
	$ 9,900	$ 7,090

At December 31, 1977 the Company had the following approximate deductions and credits available to reduce tax payments which would otherwise be required in future years:

Canada	
Exploration and development expenditures	$16,100,000
Capital cost allowance	2,600,000
Depletion allowance	11,500,000
United States	
Tax operating loss	4,400,000
Investment tax credits	2,800,000

Upon utilization, the benefits of these carryforwards will be credited to the deferred income tax provision in the balance sheet except for approximately $3,700,000 related to Canadian depletion which will be credited to income.

At December 31, 1977 undistributed earnings of subsidiaries amounted to $17,095,000. Taxes payable upon distribution, which could amount to approximately 15%, have not been provided since management believes that either such earnings will not be distributed in the foreseeable future or that no tax expense would be incurred because of available credits or deductions.

7. CAPITAL STOCK

The Company is authorized to issue 5,000,000 Preferred shares of U. S. $20 par value each and 25,000,000 (increased from 15,000,000 during 1976) Common shares of the par value of Can. $1. The Preferred shares are issuable in series, 1,303,000 shares having been designated as $.70 (U.S.) Non-Cumulative Preferred Shares, Convertible Series A. Changes in issued Capital stock and contributed surplus are summarized below (in thousands of dollars):

	Series A Preferred Shares		Common Shares		
	Number of Shares	Amount	Number of Shares	Amount	Contributed Surplus
Balance 1/1/76	1,208,009	$24,160	10,368,701	$9,860	$47,235
Issuance of warrants					2,242
Exercise of stock options			19,500	20	75
Balance 12/31/76	1,208,009	24,160	10,388,201	9,880	49,552
Conversion of Series A Preferred shares into Common shares	(11,550)	(231)	23,100	21	210
Exercise of stock options			47,700	46	183
Balance 12/31/77	1,196,459	$23,929	10,459,001	$9,947	$49,945

Each Series A Preferred share is convertible at any time, at the option of the holder into two Common shares, such rate of conversion being subject to adjustment in specified circumstances. Series A Preferred shares may be redeemed by the Company at U.S. $20 per share.

In connection with the acquisition of Hanover Petroleum Corporation, the Company issued 1,630,749 warrants each of which entitles the holder to purchase one of the Company's Common shares at a price of U. S. $10. Unless extended by the Company for up to four years, the warrants will expire December 31, 1980.

During 1975 the Board of Directors of the Company, and subsequently the shareholders, authorized the issuance of options to purchase 300,000 of the Company's Common shares. Under the plan, options may be granted to officers and employees through November 30, 1980. Holders of options may exercise at any time within five years of the date of grant but only while they continue to be employees. No charges to income were made in connection with the option plan. At December 31, 1977 options to purchase 173,800 Common shares at $4.75 to $6.83 per share were outstanding to employees (70,000 to senior officers) and 59,000 shares were available for granting of options.

Dividends were paid at the annual rate of U.S. $.70 per Series A Preferred share, with payments on a quarterly basis, in each of the years. A dividend of Can. $.05 per share on Common shares was declared in 1977 for payment in 1978.

8. EARNINGS PER SHARE

Earnings per share reflected in the Consolidated Statement of Income are calculated pursuant to United States practice rather than Canadian practice since this results in more conservative amounts than basic earnings per share under Canadian practice.

Earnings per share are computed on the weighted average of the Common shares outstanding during the period plus common equivalent shares represented by shares issuable upon conversion of Series A Preferred shares. Shares reserved for exercise of warrants and options are excluded from the calculation since assuming their issuance would result in an increase or insignificant decrease in the earnings per share amount.

The average shares used in calculation of earnings per share were as follows:

	1977	1976
Common shares	10,417,142	10,378,743
Assumed conversion of Series A Preferred shares	2,412,460	2,416,018
	12,829,602	12,794,761

Notes to Consolidated Financial Statements

Under Canadian practice basic earnings per share are calculated based on the net income available to Common shares (net income less dividends on Preferred shares) and the weighted average number of Common shares outstanding. The calculation of fully-diluted earnings per share is based on net income increased by earnings which would be realized from investment of proceeds on exercise of warrants and options. The shares used in the calculation include the weighted average Common shares outstanding plus the weighted average shares reserved for conversion of Preferred shares and exercise of warrants and options. Earnings per share pursuant to Canadian practices are as follows:

	1977	1976
Basic	$1.36	$.93
Fully-diluted	1.07	.81

9. PENSION PLANS

Pension expense for all plans was $1,526,000 in 1977 and $1,386,000 in 1976. Unfunded prior service costs aggregated $2,945,000 at December 31, 1977.

10. LEASE COMMITMENTS

The present value of future rentals under all long-term agreements (excluding leases of oil and gas properties) approximates $8,600,000 at December 31, 1977. Minimum annual rental payments on the above leases are approximately $1,400,000 per year through 1982, $900,000 per year for 1983 through 1987, $275,000 per year for 1988 through 1993.

Aggregate rental expense, including short-term rentals but excluding leases of oil and gas properties, was $2,060,000 in 1977 as compared with $1,842,000 in 1976.

11. IMPENDING CHANGE IN ACCOUNTING POLICIES

In December, 1977 the Financial Accounting Standards Board issued its Statement of Financial Accounting Standards No. 19. This statement establishes accounting rules for exploration and development expenditures and certain related transactions which will become effective for 1979. Since the rules are significantly different from the Company's accounting policies, it will be necessary to restate the financial statements for prior years to conform to the new principles. While the precise amounts have not yet been determined, the Company estimates that the accumulated effect of the restatement for 1977 and all prior years would be to decrease retained earnings by $43,000,000 to $47,000,000, property, plant and equipment, net by $72,000,000 to $80,000,000, and deferred income tax provisions by $29,000,000 to $33,000,000. Net income would be reduced by $5,500,000 to $7,500,000 for 1977 and by $7,500,000 to $9,500,000 in 1976. In addition, the Company would be required to reclassify $50,200,000 of deferred credits to long-term debt at December 31, 1977 because of rules requiring that the deferred production income related to certain conveyances of oil and gas producing properties be considered debt.

The Company believes that adoption of the rules prescribed by the FASB will not affect its ability to comply with the covenants in its debt agreements. Since the change in the rules does not reflect a change in the economic substance of the transactions, but only requires the reclassification of certain accounts; it therefore does not affect the capability of operations to generate funds, hence the Company does not expect the accounting change to affect the Company's dividend policy.

12. BUSINESS SEGMENTS

The Company's operations can be divided into two business segments. Exploration and Production includes the location, development and production of petroleum and natural gas reserves. Refining and Marketing includes the refining of crude oil and the distribution and marketing of refined products. Other income (principally financial) and expenses incurred at the corporate level are not allocated to the segments. Unallocated assets are cash and short-term investments. Depreciation and depletion expense was $13,821,000 for Exploration and Production and $3,272,000 for Refining and Marketing in 1977. Capital expenditures were $36,905,000 for Exploration and Production and $13,243,000 for Refining and Marketing in 1977.

The following tables summarize the Company's revenues, operating profit and total assets by business segment and geographic area for the year ended December 31, 1977 (in thousands of dollars):

	Business Segment			
	Exploration and Production	Refining and Marketing	Unallocated	Total
Revenue	$ 41,530	$306,698	$ 1,241	$349,469
Operating profit	$ 18,209	$ 14,341		$ 32,550
Unallocated expenses net of unallocated revenue				(294)
Interest expense				(7,392)
Income before taxes				$ 24,864
Assets at December 31, 1977	$189,384	$105,248	$56,558	$351,190

	Geographic Area				
	United States	Canada	Unallocated	Adjustment and Elimination	Total
Revenue	$331,721	$16,507	$ 1,241		$349,469
Operating profit	$ 17,831	$10,119		$4,600*	$ 32,550
Unallocated expenses net of unallocated revenue					(294)
Interest expense					(7,392)
Income before taxes					$ 24,864
Assets at December 31, 1977	$197,979	$89,553	$56,558	$7,100*	$351,190

*Consolidating adjustment to depletion of petroleum and natural gas interests.

13. QUARTERLY RESULTS (unaudited)

The following summarizes certain quarterly financial information for 1977 and 1976:

	Quarter Ended				
	March 31	June 30	September 30	December 31	Total
	(In thousands of dollars except per share amounts)				
1977					
Revenue	$81,358	$84,271	$89,489	$94,351	$349,469
Provision for income taxes	2,470	3,680	2,250	1,500	9,900
Net income	3,562	4,412	3,787	3,203	14,964
Net income per share	.28	.34	.30	.25	1.17
1976					
Revenue	$66,391	$72,776	$75,145	$84,406	$298,718
Provision for income taxes	1,387	1,913	2,168	1,622	7,090
Net income	1,643	2,306	3,009	3,488	10,446
Net income per share	.13	.18	.23	.28	.82

During the fourth quarter of 1976 inventories were reduced. This reduction resulted in a liquidation of LIFO inventories carried at lower costs as compared with the cost of 1976 purchases. As a result net income was increased by approximately $250,000, or $.02 per share.

14. RELATED PARTY TRANSACTIONS

During 1977 and 1976 the Company purchased crude oil at market prices from Total International Limited, a wholly-owned subsidiary of Compagnie Française des Pétroles ("CFP"), a French corporation which owns approximately 50% of the voting shares of the Company. The aggregate of such purchases was $33,800,000 in 1977 and $51,900,000 in 1976. Accounts payable at December 31, 1977 includes $6,200,000 (1976—$6,665,000) related to these purchases.

The Company participates in a joint venture exploring for hydrocarbons with six other companies, one of which is a wholly-owned subsidiary of CFP and operator of the venture. The Company holds a 5% interest in the venture which was inactive in 1977. In 1976 the Company incurred costs aggregating $2,000,000.

Long-term debt includes a $4,000,000 note payable to a CFP affiliate. The terms of this borrowing are consistent with arrangements with other lenders.

15. STATUTORY INFORMATION

During 1977 the direct remuneration paid to the Company's ten directors was $43,200 and to the eight senior officers was $591,800. One officer is also a director of the Company.

16. REPLACEMENT COST AND VALUE OF RESERVES (unaudited)

Regulations of the Securities and Exchange Commission adopted in 1976 require the inclusion of certain replacement cost information in reports filed with the Commission. In 1977, the Commission proposed that the present value of estimated future net revenues from proved oil and gas reserves also be included in reports. The Company has concluded that it should incorporate a portion of the proposed value information into this report because of its significance to any presentation intended to provide more relevant information about the current economics of the business enterprise than that presented in the historical cost basis financial statements. This is the intent expressed by the Commission in adopting the replacement cost and in proposing the value information requirements. The Company believes that the calculations are based on reasonable assumptions and judgments as necessary to comply with the requirement and the proposal, but that the resulting information should be viewed only as approximations usable only within the context presented.

Present Value of Estimated Future Net Revenues From Proved Reserves

The present value of estimated future net revenues from proved reserves was $215,000,000 at December 31, 1977. The historical cost of these assets, net of accumulated depreciation and depletion, was $175,761,000. In calculating the value of future net revenues; prices and costs in effect at December 31, 1977 were assumed to continue for all future periods, provision was made for estimated future development expenditures that will be required to produce the estimated reserves, and future revenues were discounted to their present value at estimated current borrowing rates for loans secured only by future production (8½%). The value amount should not be viewed as the amount which might be realized in a sale of the reserves in-place nor should it be interpreted as the amount which will be ultimately realized from production from the properties.

Replacement Cost

The Commission has warned, and the Company agrees, that the data presented below should not be interpreted as showing the complete effect of inflation. Other factors which must be considered include holding gains and losses on monetary assets and liabilities, potential operating efficiencies resulting from the replacement facilities and the tax savings that might result from the replacement of all productive capacity.

The following table presents the estimated replacement cost of inventories and productive capacity at December 31, 1977 and 1976 and the related depreciation and depletion accumulated and for the years then ended. The cost was determined by methods considered most appropriate for each functional type of asset. Price level indexes were only used in calculating depreciation. Current environmental requirements were considered in all areas where the impact was considered significant. Historical cost information, presented for comparative purposes, is adjusted to exclude land, mineral resource assets and facilities which would not be replaced under current conditions. Adjustment is also made to add non-capitalized financing leases.

	Millions of Dollars			
	Historical cost		Replacement cost	
	1977	1976	1977	1976
Inventories	$22	$19	$ 38	$ 34
Productive capacity:				
Refining	$43	$32	$147*	$140
Supply and transportation	18	17	33	31
Marketing	15	15	16	16
Other	4	4	6	6
	80	68	202	193
Accumulated depreciation and depletion	31	28	102	114
Net investment	$49	$40	$100	$ 79
Depreciation expense	$ 4	$ 4	$ 8*	$ 8

*The replacement cost for refining capacity was derived from engineering estimates of the cost of a one-time replacement of the present facility. The hypothetical refinery includes current technology and specifications best suited to the Company's current needs. The replacement refinery would be different from the present operation in several respects including the following approximations:

1. 19% increase in crude oil throughput capacity.
2. 23% increase in total yield of salable products.
3. 38% increase in yield of gasolines.

Report of Independent Accountants

It is not practical to accurately estimate the substantial financial benefits that would be realized from the operation of such a facility. The increase in overall capacity and, particularly, gasoline yield would allow the substitution of lower cost manufactured products for products currently purchased from other refiners, virtually eliminating such purchases. The increase in total salable yield is directly related to increased energy efficiency and would result in lower operating cost per barrel.

The replacement cost for supply and transportation assets was based on engineering estimates for individual locations except that calculations prescribed by the Interstate Commerce Commission for rate-making purposes were used for assets subject to regulation by that agency. The engineering estimate of the cost to construct and equip a typical retail outlet was used for each marketing asset that would be replaced under current conditions. The replacement cost of other assets, principally office buildings and equipment and vehicles, was determined from engineering estimates and vendor price lists.

The accumulated and 1977 and 1976 depreciation were calculated using the ratio of the related historical cost amounts to the historical cost assets. Generally, this calculation was made on a composite basis for each physical location. Where the composite included significant assets acquired in different historical periods, price level indexes were used to develop a more appropriate relationship.

Cost of purchased crude oil, products and merchandise generally reflects the replacement cost of inventories at the date of sale. A reduction in inventories during the last quarter of 1976 resulted in costs being charged at prices approximately $500,000 lower than current replacement cost.

To the Shareholders of
Total Petroleum (North America) Ltd.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of changes in financial position present fairly the financial position of Total Petroleum (North America) Ltd. and its subsidiaries at December 31, 1977 and 1976, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Detroit, Michigan
February 10, 1978

Directors and Officers

BOARD OF DIRECTORS

Reid Brazell
Formerly Chairman of the Board
and Chief Executive Officer;
Retired, Frankfort, Michigan

Martin E. Citrin
Partner, J. A. Citrin Sons Co.,
Real Estate and Investments,
Southfield, Michigan

F. Campbell Cope, Q. C.
Partner, Ogilvy, Montgomery,
Renault, Clarke, Kirkpatrick,
Hannon & Howard; Barristers
and Solicitors, Montreal, Quebec

Etienne L. Dalemont
Formerly Chairman of the Board;
Formerly Managing Director of
Compagnie Française des Pétroles;
Retired, Paris, France

Philippe Dunoyer
President, Alma, Michigan

Joseph-Camille Genton
Vice President and Finance Director of
Compagnie Française des Pétroles,
Paris, France

James W. Glanville
Managing Director of Lehman
Brothers Kuhn Loeb Incorporated,
New York, New York

Andre M. Jacqmin
President of Total Eastcan
Exploration, Ltd.; Chairman of
Total Groenland Olje A/S,
Paris, France

Linden J. Richards
Oil and Gas Consultant,
Tucson, Arizona

David L. Torrey
Senior Vice President and Director
of Pitfield Mackay Ross Limited,
Investment Dealers, Montreal, Quebec

PRINCIPAL OFFICERS AND EXECUTIVES OF TOTAL PETROLEUM (NORTH AMERICA) LTD. AND SUBSIDIARIES

James W. Glanville
Director and Chairman of the Board,
New York, New York

Philippe Dunoyer
Director and President, Alma, Michigan

Robert R. Dean
Vice President-Manufacturing, Supply
and Transportation, Alma, Michigan

John E. Fawke
Vice President-Marketing,
Romulus, Michigan

Paul H. Gutknecht
Vice President-Finance and Treasurer,
Alma, Michigan

Gilbert M. Kiggins
Vice President, New York, New York

Philippe Magnier
Vice President-Exploration and Production,
Houston, Texas

William G. Tucker
Vice President and General Counsel,
Calgary, Alberta

Robert A. Wall
Vice President, Secretary and General
Manager–Canadian Division, Calgary, Alberta

William F. Kellock
Vice President-Production, Calgary, Alberta

Colin S. MacDonald
Assistant Treasurer, Calgary, Alberta

Glenn R. Moore
President of Hanover Petroleum Corporation,
Dallas, Texas

John B. O'Brian
Vice President-Personnel and Industrial
Relations of Total Petroleum, Inc.,
Alma, Michigan

Richard E. Dana
Controller of Total Petroleum, Inc.,
Alma, Michigan

Total Petroleum (North America) Ltd.

CORPORATE HEADQUARTERS

639 Fifth Avenue, S.W.
Calgary, Alberta T2P OM9
Telephone 403/265-9080

SUBSIDIARIES

Total Petroleum, Inc.

Corporate Headquarters
East Superior Street
Alma, Michigan 48801
Telephone 517/463-1161

Exploration & Production Headquarters
2950 One Allen Center
500 Dallas Avenue
Houston, Texas 77002
Telephone 713/658-0972

Marketing Headquarters
28001 Citrin Drive
Romulus, Michigan 48174
Telephone 313/946-5500

Hanover Petroleum Corporation

211 N. Ervay
Dallas, Texas 75201
Telephone 214/651-8133

5 Hanover Square
New York, New York 10004
Telephone 212/952-4646

REGISTRARS

The Royal Trust Company
Calgary, Regina, Winnipeg,
Toronto and Montreal, Canada

Morgan Guaranty Trust Company
of New York
New York, New York

TRANSFER AGENTS

Montreal Trust Company
Calgary, Regina, Winnipeg,
Toronto and Montreal, Canada

Morgan Guaranty Trust Company
of New York
New York, New York

AUDITORS

Price Waterhouse & Co.

EXCHANGE LISTINGS

Toronto Stock Exchange
Montreal Stock Exchange
American Stock Exchange

FORM 10-K

Copies of the Company's annual report to the Securities and Exchange Commission on Form 10-K are available without charge upon request to the Company at East Superior Street, Alma, Michigan 48801, U.S.A.

Direct shareholder and security analyst inquiries to—
Gilbert Kiggins, Vice President
Total Petroleum, Inc.
5 Hanover Square
New York, New York 10004
Telephone 212/952-4621

ANNUAL MEETING

Shareholders are cordially invited to attend TOTAL's Annual Meeting to be held this year at the Queen's Quay, Convention Centre
Harbour Castle Hotel, One Harbour Square, Toronto, Ontario M5J 1A6 on Wednesday, May 3, 1978 at 11:00 a.m.

TOTAL®

Total Petroleum (North America) Ltd.

Interim Report

SIX MONTHS ENDED
JUNE 30
1977

TOTAL

to our shareholders

Funds generated from operations during the first half of 1977 were $22,819,000, up from $13,091,000 for the same period in 1976. Net income increased to $7,974,000, or $0.62 per share, from $3,949,000, or $0.31 per share, in the first six months of 1976.

Approximately 40% of the increase in funds generated from operations was accounted for by Hanover Petroleum Corporation, acquired on April 30, 1976. Funds generated by other U.S. and Canadian producing properties continued their steady upward trend. Funds provided by refining and marketing operations were above expectations, and above seasonal trends, as a result of high demand and firm prices during and following the past winter.

During the second quarter, funds generated from operations were $12,598,000 compared to $7,970,000 for the second quarter last year. Net income was $4,412,000 versus $2,306,000 for the same quarter in 1976.

operations

Exploration activities in Canada during the first six months were hampered by an unusually warm winter resulting in a short drilling season. TOTAL participated in 29 wells, resulting in one oil and ten gas discoveries. A significant amount of new acreage was leased in Alberta.

Recently the Canadian government announced a schedule of price increases for oil and gas. As of July 1st, oil prices increased $1.00 per barrel in Canada. Gas prices increased $0.175 per MCF on August 1st. Further increases are scheduled for next year. These increases continue to enhance the Company's long-established Canadian oil and gas production position.

During the first six months, TOTAL and Hanover Petroleum participated in 104 wells in the U.S. resulting in 24 oil and 10 gas discoveries. The most significant results have been obtained in Michigan, Illinois and Texas.

The sale of Hanover Series 16 Drilling Program closed April 30, 1977 and raised $3,270,000 in Limited Partner subscriptions.

As a consequence of the first phase of the Alma refinery upgrading project, gasoline yield is now approximately 55% versus an average 50% in previous years. Crude runs have averaged 42,071 BPD during the first six months versus 38,520 BPD for all of 1976. The refinery upgrading project is on schedule and may be completed by the end of the current year. Upon completion, the refinery will be capable of producing 65% gasoline.

apco acquisition

One of your Company's long-stated goals has been to seek carefully selected acquisitions. On June 22nd, TOTAL announced the signing of a letter of intent with Apco Oil Corporation which calls for TOTAL to purchase Apco's Arkansas City, Kansas refinery (46,000 BPD capacity), and all associated crude oil and refined product pipelines and terminals as well as Apco's Canadian producing oil and gas properties. The purchase price will be U.S. $65 million, subject to certain adjustments, plus inventories and receivables at the closing. The purchase is subject to the approval by Apco and TOTAL of a definitive agreement, approval of various U.S. and Canadian regulatory authorities as well as approval of a plan of complete liquidation by the stockholders of Apco Oil Corporation.

The Arkansas City facility will more than double your Company's refining capacity. This refinery was recently modernized, with a new crude unit and a catalytic reformer placed in commission in 1974 and 1975. The facility is capable of manufacturing a high yield of gasoline. Agreements relating to the current supply of domestic crude oil for the Arkansas City refinery will be transferred from Apco to

TOTAL when the transaction is closed. The purchase of the refinery, pipelines and terminals, supplying customers in fourteen Mid-Continent states, will extend TOTAL's refining and marketing operations and enhance its gasoline manufacturing and distribution flexibility. The United States has a permanent deficit of refinery capacity. This, as well as other basic factors, has improved the economics of refining and marketing in the U.S. in the past few years.

The acquisition of Apco's Canadian producing properties will increase TOTAL's proven reserve position in Canada (29 million barrels oil; 175 billion cubic feet gas at 12/31/76) by approximately 10 percent. Canadian policies, both federal and provincial, affecting oil and gas pricing indicate that increased prices may be expected from this production in the future.

Upon closing of this purchase, and following the acquisition of Hanover Petroleum Corporation in 1976, TOTAL will have increased its investments in North America by over $110 million during the past two years. The acquisitions are in areas of the petroleum industry that add to TOTAL's existing strengths.

u.s. energy policy

President Carter's energy program is currently progressing through the Congress of the United States. In its present state, it is not anticipated that the program will have a negative impact on the competitive position of TOTAL. However, the plan is not in final form. We will continue to carefully assess its impact as the program develops.

We concur with the premise of the President's plan that conservation of energy is fundamental to a national energy policy. But conservation alone is not enough. Petroleum will continue to be a primary energy source through this century. Given adequate incentives, there are new supplies of oil and natural gas to be found.

We look to the remainder of 1977 with confidence. We expect to achieve our major goal of significantly increasing funds generated from operations in all areas of our operation.

On behalf of the Board of Directors

Philippe Dunoyer
President

August 8, 1977

operating data

	Six Months Ended June 30	
	1977	1976
Crude oil and condensate production before royalties (BPD):		
Canada	5,075	5,192
U.S.	4,705	1,936
Natural gas sales before royalties (MCF/Day):		
Canada	19,895	17,612
U.S.	25,803	13,812
Crude oil refined (BPD)	42,071	38,643
Refined product sales (BPD)	48,027	47,154
Gasoline sales (BPD)	29,004	29,142

consolidated statements of changes in financial position

(United States Dollars)

	Six Months Ended June 30 1977	1976
Funds were provided by:		
Operations —		
Net income for the period	$ 7,974,000	$ 3,949,000
Income charges (credits) not affecting working capital in the period:		
Depreciation, depletion and amortization	8,695,000	5,842,000
Deferred income taxes	6,150,000	3,300,000
	22,819,000	13,091,000
Additional long-term borrowings	6,054,000	49,795,000
Proceeds from sale of future production	4,000	1,696,000
Sale of properties	724,000	712,000
Issuance of equity securities	87,000	2,261,000
Total funds provided	29,688,000	67,555,000
Funds were used for:		
Capital expenditures —		
Petroleum and natural gas interests and production equipment	12,751,000	60,105,000
Refining, marketing and transportation	5,528,000	1,531,000
Other	54,000	432,000
Long-term debt paid or reclassified to current liabilities	7,485,000	7,213,000
Dividends paid	421,000	423,000
Reductions of deferred income	61,000	966,000
Other	627,000	437,000
Total funds used	26,927,000	71,107,000
Increase (decrease) in working capital	$ 2,761,000	$ (3,552,000)
Changes in components of working capital:		
Working capital, beginning of period	$ 8,604,000	$ 19,108,000
Increase (decrease) in current assets:		
Cash and short-term investments	(2,813,000)	(7,174,000)
Accounts and notes receivable	(570,000)	9,605,000
Inventories	6,077,000	273,000
Other	(508,000)	(241,000)
	2,186,000	2,463,000
(Increase) decrease in current liabilities:		
Notes payable	—	(2,000,000)
Accounts payable and other accrued liabilities	3,006,000	504,000
Accrued taxes	(464,000)	(1,360,000)
Current portion of long-term debt	(1,967,000)	(3,159,000)
	575,000	(6,015,000)
Working capital, end of period	$ 11,365,000	$ 15,556,000

consolidated statements of income

(United States Dollars)

	Six Months Ended June 30 1977	1976
REVENUE:		
Net sales of refined products	$144,174,000	$125,850,000
Net sales of crude oil and natural gas	20,297,000	12,486,000
Other income	1,158,000	831,000
	165,629,000	139,167,000
EXPENSES:		
Purchased crude oil, products and merchandise	110,332,000	99,648,000
Operating	18,041,000	14,370,000
Marketing and administrative	10,962,000	9,614,000
Depreciation, depletion and amortization	8,695,000	5,842,000
Interest	3,475,000	2,444,000
Provision for income taxes	6,150,000	3,300,000
	157,655,000	135,218,000
NET INCOME FOR THE PERIOD	$ 7,974,000	$ 3,949,000
NET INCOME PER SHARE	$.62	$.31
Average outstanding shares	12,809,702	12,788,386

	Three Months Ended June 30 1977	1976
Sales and other income	$ 84,271,000	$ 72,776,000
Provision for income taxes	$ 3,680,000	$ 1,913,000
NET INCOME FOR THE PERIOD	$ 4,412,000	$ 2,306,000
NET INCOME PER SHARE	$.34	$.18
Average outstanding shares	12,813,152	12,788,719

NOTES: Net income per share is computed assuming full conversion of Series A Preferred shares into Common shares. Common equivalent shares represented by warrants and employee stock options are not included in the calculation since assuming exercise is antidilutive or insignificant.

Dividends to the Series A Preferred shareholders were at the rate of 35 cents per share for each of the six month periods and aggregated $421,000 for 1977 and $423,000 for 1976.

The financial statements include all normal adjustments and accruals, but are unaudited.

LITHOGRAPHED IN CANADA